Supplemental Information

received after the completion of the report.

Payday Lending Study Issue

Public Comment.

August 1, 2013

Sunnyvale City Council
Honorable Mayor and Council Members
Sunnyvale City Hall
456 West Olive Avenue
Sunnyvale, CA 94088-3707

Dear Mayor Spitaleri and Members of the City Council:

I am writing in regard to the "Payday Lending Study Issue" scheduled to be heard by the Planning Commission on Monday, August 26th and by the Council on Tuesday, September 24th. We are standing with Sunnyvale Community Services and the Coalition Against Payday Predators (CAPP) in urging you to adopt an ordinance putting a cap on the number of payday lenders in the city and setting forth permitting and distance requirements for any new payday loan storefronts.

Having heard about the activities of these lenders, we are concerned about the predatory practices of this industry, particularly as they affect working people who face hardships due to the irresponsibility of these lenders, including the 459% APR and cycle of debt encouraged by these lenders. Through these short term loans at exorbitant rates often targeted to low and middle-income communities, families and individuals become trapped in a cycle of debt from which they cannot escape.

The Catholic Diocese of San Jose represents fifty-four parishes and missions in Santa Clara County. Three of these parishes are located within the City of Sunnyvale. The Catholic Church has a long tradition of standing with the poor and marginalized. As the US Bishops stated:

> *All economic life should be shaped by moral principles. Economic choices and institutions must be judged by how they protect or undermine the life and dignity of the human person, support the family and serve the common good.* *-A Catholic Framework for Economic Life, 1996*

In this spirit, we stand with the working families and those on the margins who are victimized by predatory lenders and respectively encourage the Council to approve a restrictive payday ordinance when it comes before you.

Sincerely,

Linda L. Batton
Director of Social Ministries

Cc: Amber El-Hajj, Senior Planner, Department of Community Development, Sunnyvale Planning Commission

Amber El-Hajj <ael-hajj@sunnyvale.ca.gov>

RE: Payday Lending Ordinance

Garcia, Sophia <sagarcia@advanceamerica.net> Thu, Aug 22, 2013 at 10:22 AM
To: "ael-hajj@sunnyvale.ca.gov" <ael-hajj@sunnyvale.ca.gov>, "tryan@sunnyvale.ca.gov" <tryan@sunnyvale.ca.gov>, "hhom@sunnyvale.ca.gov" <hhom@sunnyvale.ca.gov>

Good afternoon Amber,

It was a pleasure speaking to you on the phone yesterday.

In an effort to provide you with some additional information as a follow up to our call, I have included the attached documents in an effort to dispel any concerns that the Planning Commission and staff may have regarding payday lending.

Should you have any additional questions or concerns, please don't hesitate to call me.

If it is too late to include these documents in each of the Planning Commissioner's packets for the meeting, please let me know and I will be sure to bring copies to Monday's meeting.

Kind regards,

Sophia A. Garcia

State Director, Government Affairs

Advance America

916-601-5854

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7 attachments

Why Payday Loans are Good for Millions of People - Bank Think Article - American Banker.pdf

182K

UCD Stango Fall 2012.pdf
779K

Payday Lending Best Practices Help Prevent so-called Cylce of Debt.pdf
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Fact vs Fiction_Payday advance.pdf
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Payday Lenders Provide Desired Service to Lower and Moderate Income, Middle-Educated, Young American Families.pdf
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Why Payday Advance is Not Predatory Lending.pdf
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Why Payday Loans are Good for Millions of People

William Isaac
AUG 13, 2013 10:00am ET

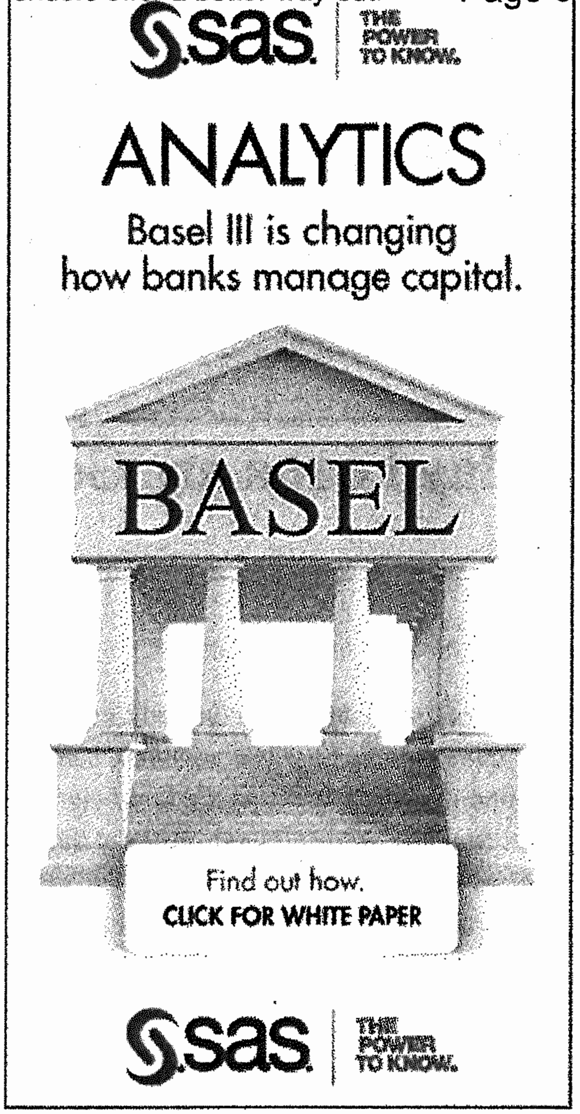
The Justice Department and state regulators are targeting banks that service a broad range of what they consider questionable financial ventures, including some online payday lenders. I applaud the government's efforts to weed out bad actors that engage in fraudulent transactions or violate federal laws. But I'm deeply concerned about the unintended consequences this could have on much needed financial services for underbanked people who rely on legitimate short-term lenders, commonly referred to as payday lenders.

Payday lending is pretty simple. An individual has an urgent short-term need for cash and goes to a payday lender. A person with a job, a checking account and proper identification can borrow anywhere from $100 to $500 until his or her next payday. Such borrowers write post-dated checks or provide written authorizations to the payday lender for the amount of the loan plus a fee, which is typically 15%. On the next payday the loan is either repaid in person by the borrower or the lender cashes the check or initiates an electronic funds transfer. That's it.

The typical first-time payday transaction is completed within 15 minutes. Very few banks are willing to make these loans – the transaction costs are simply too high.

Millions of middle-income Americans live paycheck to paycheck. They do their best to manage their finances so that all their obligations are met. But when something unexpected crops up, such as a blown transmission, an unexpected doctor's bill or a badly needed roof repair, their financial schedules are thrown off and the need for short-term credit may arise.

Some turn to relatives or friends for help in a crunch. But many may face the Hobson's choice of deciding between having their electricity turned off, their car repossessed, their job lost, their rent or mortgage unpaid or their check bounced. Payday lenders offer a better way out.



Critics of payday lending cite the high interest rates they charge. A $15 fee on a $100 advance for two weeks amounts to a 391% annual percentage rate, or APR. That's high when expressed as an annual rate, but keep in mind that the typical term of these loans is a couple of weeks. It's also notable that the annualized interest rate on the average payday loans is much lower than it would be for the fee on a bounced check or a late mortgage or credit card payment.

The $15 cost of a $100 payday loan also pales in comparison with the lost income when a car is out of commission and a job lost. Good payday lenders clearly disclose their loan terms and conditions, including the dollar amount of any fees and the APR. Moreover, payday lenders are regulated and supervised by state agencies and also the new federal Consumer Financial Protection Bureau. My firm has worked with payday lenders to get them into compliance with regulations applicable to banks.

Some online lenders avoid regulation by setting up operations offshore or on an Indian reservation outside the reach of regulators. I applaud the regulators for attempting to shut down such operations by denying them access to the banking system.

But I also caution about the potentially unintended consequences of driving all payday lenders away from banks. This is the last thing we need at a time when the economy is languishing, in significant part because only the most creditworthy can qualify for a bank loan.

At this point, banks would be well advised to conduct proper due diligence on their payday lending customers to determine whether they are following state and federal laws, have established written regulatory compliance and anti-money laundering programs, follow trade association best practices and obtain from valid customer authorizations for automatic funds transfers. If a payday lender cannot answer these questions affirmatively, the bank is likely working with the wrong customer.

Some argue that payday loan portfolios have enormous losses imbedded in them because the loans are never really repaid – just rolled over and over again. But most states limit the number of rollovers, and most payday lenders impose similar limits, even in the absence of state laws.

The risks of payday lending are ameliorated due to the enormous diversification in the portfolios, and risks are priced into the fees. It's feasible for a reputable and efficient payday lender to maintain high loan loss reserves and substantial capital against payday loans and still achieve decent returns.

The regulators would do well to examine the welfare of borrowers in a variety of regulatory settings before they act in a way that might endanger the very people they are trying to protect – the underbanked. The truth is that millions of customers have a very favorable experience with the short-term lending product, and we should be careful not to disrupt this important lifeline.

William Isaac, a former chairman of the Federal Deposit Insurance Corp., is the global head of financial institutions for FTI Consulting, which has worked for payday lenders, and the chairman of Fifth Third Bancorp. The views expressed are his own.

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Are Payday Lending Markets Competitive?

Despite their claims, credit unions seem unable to offer competitive payday loans.

BY VICTOR STANGO

The rapid and widespread growth of the payday loan market has sparked considerable controversy, in part regarding the "high" prices charged on payday loans. Are such accusations warranted? Payday lenders argue that their loans do not yield excess profits once one accounts for the full economic costs of the business. Banks and credit unions, however, argue that prevailing fees more than cover costs; credit unions in particular argue that they can effectively serve the same borrowers at lower prices.

This article presents several new pieces of evidence addressing the question. Can credit unions provide functionally identical payday loans at a lower price, or offer a different product with a price/characteristic mix that payday borrowers prefer? Considering both prices and non-price characteristics is critical, because even lower-priced credit union payday loans cannot compete with standard payday loans if they have qualitative characteristics that potential borrowers find extremely unattractive, or if they screen potential borrowers out of the market through tighter credit approval requirements.

The most direct evidence is the most telling in this case: very few credit unions currently offer payday loans. Fewer than 6 percent of credit unions offered payday loans as of 2009, and credit unions probably comprise less than 2 percent of the national payday loan market. This "market test" shows that credit unions find entering the payday loan market unattractive. With few regulatory obstacles to offering payday loans, it seems that credit unions cannot com-

VICTOR STANGO is an associate professor in the Graduate School of Management at the University of California, Davis and an associate editor of the *International Journal of Industrial Organization*.

pete with a substantively similar product at lower prices.

Those few credit unions that do offer a payday advance product often have total fee and interest charges that are quite close to (or even higher than) standard payday loan fees. Credit union payday loans also have tighter credit requirements, which generate much lower default rates by rationing riskier borrowers out of the market. The upshot is that risk-adjusted prices on credit union payday loans might be no lower than those on standard payday loans.

A final point—one that is too often ignored in policy discussions—is that borrowers find the non-price characteristics of standard payday loans superior to the non-price features of credit union payday loans. Credit unions have locations and business hours that consumers find less convenient than those of commercial payday lenders. Application times are longer at credit unions. And default on a credit union payday loan may harm one's credit score, while default on a standard payday loan does not harm one's credit score. Current payday loan customers view these restrictions negatively, expressing a preference for a less restrictive but higher-priced payday loan over a more restrictive and lower-priced payday loan. Borrowers also dislike the lack of privacy conferred because credit union payday loans do not "keep my payday borrowing separate from my other banking."

In short, the claim that other financial institutions can serve the market at lower prices does not seem justified. At lower rates and fees, credit unions are either deterred outright from offering payday loans or are only willing to offer a type of loan that potential borrowers find unappealing.

Payday Lending: A Primer

A payday loan is a short-term advance against a future paycheck. A payday lender generally advances a customer $100–$500 per loan. In return, the borrower leaves a postdated check with the lender for the loan principal plus fees, and the lender deposits the check after two weeks. The loan fee, which one can view as an interest charge, is typically about $15 per $100 advanced.

Payday advances are uncollateralized, like credit cards and unlike home and auto loans. Approval requirements are minimal; a recent bank account statement, a pay stub, and photo identification are often enough for approval. In most cases, the only cause for denial is recent default on a payday loan. Because payday lenders generally track prior payday advance defaults using databases independent from the major credit bureaus, approval decisions and prior defaults do not affect borrowers' credit reports. For borrowers, the looser credit standards are attractive. The downside for lenders is more frequent default because the loans are uncollateralized and payday lenders lend money to riskier borrowers.

ILLUSTRATION BY MORGAN BALLARD

Payday lenders compete on location and convenience as well as price. The scale of a payday outlet can be quite small and startup costs are minimal compared to those of a bank. Payday lenders quickly saturate attractive markets. They can locate nearly anywhere and have longer business hours than banks. Borrowers seem to have little trouble understanding payday lenders' prices because the price structure is much simpler than that for most other loans.

Demand for payday lending is substantial and has become widespread in the United States during the last 20 years. There are currently more than 24,000 physical payday outlets; by comparison there are roughly 16,000 banks and credit unions in total (with roughly 90,000 branches). Many more lenders offer payday loans online. Estimates of market penetration vary, but industry reports suggest that 5–10 percent of the adult population in the United States has used a payday loan at least once.

Nor does borrowing appear confined to those who are "credit constrained." Recent research suggests that many payday borrowers take out loans even when they have lower-priced options such as credit cards. Payday borrowers are also aware that payday loan fees may be lower than those from overdrawing on a checking account or going over a credit card limit.

Are Payday Loans Usurious?

If one treats the standard $15 per $100 loan fee as an interest charge, the annual percentage rate (APR) on a typical payday loan is 391 percent. It is the APR that critics generally label as "too high," both because it exceeds the levels on most other consumer loans and because it exceeds the usury ceiling in most states. Critics argue that high prices justify legislation capping payday loan APRs at lower levels; such legislation has passed in some states.

"Too high" can only be measured relative to a benchmark, of course, and for most economists and policymakers the right benchmark is "breaking even," or earning zero profit in economic terms. That benchmark also helps to frame the debate as articulated by banks and credit unions. To argue that APRs charged by payday lenders are too high is to argue either that payday lenders are charging prices that are above their own break-even levels or that credit unions could break even at significantly lower rates and fees.

An important difference between payday loans and other loans is that payday loans have higher default rates. Because payday loans are uncollateralized, it is almost impossible to recover the loan principal on a bad loan. This can dramatically increase break-even loan fees.

The existing academic research identifies some key issues in the analysis of whether payday lenders charge break-even prices. Like all lenders, a payday lender must cover the full set of costs (explicit and implicit) associated with its loans. But for payday lenders the makeup of those costs is quite different from that for costs on auto or credit card loans. For a payday lender, fixed costs—rent, utilities, and the portion of labor costs that is independent of loan volume—are substantial compared to revenue. For larger loans, fixed costs are covered by much greater revenue (loan revenue per mortgage far exceeds loan revenue per payday loan, for example).

Payday loan costs also include per-loan processing costs: labor and any costs associated with credit scoring. Again, on a payday loan, these costs are more substantial in relative terms than for home and auto loans because payday loan dollar amounts are so small.

Another difference between payday loans and other loans is that payday loans have higher default rates. Because payday loans are uncollateralized, it is almost impossible to recover the loan principal on a bad loan. This can dramatically increase break-even loan fees. Suppose a payday lender faces fixed and marginal costs of $25 per loan, a figure supported by Mark Flannery and Katherine Samolyk's 2005 study of payday lenders' cost structure. With no risk of default, the break-even per-loan charge is $25. But if 5 percent of customers default and the average loan is $300, the break-even per-loan charge rises to $40.

It is worth noting that in contrast to large-principal loans (such as mortgages) on which the cost of funds comprises nearly all of the per-loan costs, payday loans have a small cost of funds relative to other costs. So, using the APR as a measure of the "markup" on a payday loan is misguided; the APR is really only a good metric of the loan markup when financing costs are the most important component of costs to the lender.

Beyond the evidence directly comparing payday lenders' costs, a smaller body of work reviewed by Jonathan Zinman shows that the imposition of rate and fee caps forces payday lenders out of business. That is what one would expect if the caps lie below break-even price levels for payday lenders. Nor do payday lenders appear to earn "excess returns" in the stock market, according to a 2009 paper by Paige Skiba and Jeremy Tobacman.

The evidence of break-even pricing is also consistent with industry structure in general, which makes persistent economic profitability unlikely. Payday lending has many characteristics associated with perfectly competitive markets, including small scale and free entry. Nonetheless, many remain skeptical of such an argument.

How Many Credit Unions Offer Payday Loan Products?

For a brief period in 2009, the National Credit Union Administration (NCUA) required credit unions to report whether they offered payday loans. Those data are publicly available and cover the entire population of federally insured credit unions in the United States at the time. The data describe, for each credit union, whether it offers payday loans as well as other detailed information about its location, size, and characteristics.

The data show that as of March 2009, of the 7,749 credit unions covered in the data, roughly 6 percent (479) offered payday loans; by June, slightly more (503) credit unions reported offering payday loans. Unfortunately, these data do not include payday loan volume at these lenders.

A back-of-the-envelope calculation is instructive, however. If each of those 479 credit unions matches the loan volume of the typical payday lender, then credit unions represent roughly 2 percent of the national payday lending market. The figure will be smaller if one includes online payday lending. It will also be smaller in states that allow payday lending, because payday lenders are concentrated there.

While the situation may change over time, the available NCUA evidence suggests two things about entry by credit unions into the payday lending market. First, relatively few credit unions find it worthwhile to enter the market. Second, entry by credit unions to date is small compared to the size of the market now served by payday lenders.

Why don't more credit unions offer payday loans? | The fact that so few credit unions offer a payday advance product raises a simple question: What is the practical obstacle to offering payday advances at lower prices? To answer that question, a survey was conducted in May 2009 to ask credit union representatives about the downsides of offering payday loans. The surveyor (a graduate student research assistant) contacted 46 credit unions via phone calls, starting from a list of 250 credit unions randomly selected from the NCUA data file of 7,749. All respondents were credit union employees, and many were loan officers or branch managers.

Very few credit unions were responsive, but among those who did supply answers the most common reason for not wanting to offer a payday loan product was that such loans are "too risky." Some of the respondents reported that assessment came as a result of direct experience, e.g., "We used to offer payday loans but stopped because delinquencies were too high." The remaining respondents split their reasons between "insufficient demand" and "interest rates are too high." The latter response is, in essence, a risk-based explanation; the rates required to break even were either unattractive to customers or above a rate that the credit union was willing to set.

While the sample here is small and it is probably best to treat the responses as anecdotal, they are consistent with a view that most credit unions do not offer payday loans because, at below-market fees and rates, it is too difficult to offset default risk. In some sense, this evidence provides a market test of whether credit unions can be competitive providers of short-term credit, and right now that test suggests a negative answer. Another possibility is that credit unions (and commercial banks) stay out of payday lending because they earn greater marginal returns on checking overdrafts. Overdraft revenue is now the single greatest component of non-interest income for banks.

What Are the Terms of the Credit Union Payday Product?

Beyond the evidence regarding entry, we can also learn about the competitiveness of the market by examining prices at those credit unions that do offer payday loans. Do those credit unions substantially undercut prevailing payday loan rates? If so, we have evidence that prevailing payday loan rates might in fact be "too high."

Data are limited, but via online sources (Google searches), the phone survey mentioned in the previous section, and a credit union industry report published by the National Credit Union Foundation, we can learn terms at roughly half of the credit unions that offered payday loans as of 2009–2010.

Two pieces of background information are necessary. First, federal credit unions face a regulatory prohibition against charging more than an 18 percent APR, which equals $1.50 per $100 of loan principal per month. Most credit unions comply with that requirement. Some state credit unions charge APRs of up to 36 percent. To offset lower loan APRs, credit unions do two things: they impose per-loan processing fees or annual loan program fees, and/or they impose restrictions on loan terms and access. The former raise prices, while the latter are intended to reduce default risk.

Second, many credit unions offer payday loans through alliances offering a standardized product and pooling default risk. The two largest alliances are Better Choice and StretchPay, located in Pennsylvania and Ohio. Better Choice has roughly 80 credit union members, while StretchPay has over 100, meaning that together these two alliances make up roughly 40 percent of the national total of credit unions that offer payday loans. So, the terms set by those alliances are very informative because they have been adopted by many credit unions. One other point worth noting is that the Better Choice program receives subsidies from the Pennsylvania state treasury. Its prices are therefore subsidized rather than market prices.

Both Better Choice and StretchPay charge an APR of 18 percent. Both also charge fees: StretchPay charges an annual fee of $35 for loan amounts of $250 and $70 for loan amounts of $500, while Better Choice charges a per-loan application fee of $25 for loan amounts up to $500. Better Choice has a 90-day repayment period, while StretchPay has a 30-day repayment period.

Table 1 shows terms of Better Choice and StretchPay loans, and shows terms at some other credit unions. Terms of other credit unions' payday loans vary somewhat, but are generally similar in structure: nearly all combine an 18 percent APR with fees. Some credit union payday loans forgo charging an APR altogether and simply charge per-$100 fees. One of the more well known of such programs is the GoodMoney program, which has a fee of $9.90 per $100 borrowed and a two-week loan term.

TABLE 1

Terms of Credit Union Payday Loan Alternatives

	Fee	APR	Maximum Term	"Savings" held back	Other restrictions
Better Choice	$35–$70 per year	18%	90 days	5%	A, E
StretchPay	$25 per loan	18%	30 days	10%	A, B, C
ADVANCPay	$60–$70 per loan	none	2 weeks	none	D
GoodMoney	$9.90 per $100	none	2 weeks	none	B
Rivermark	$15 per loan	25%	30 days	none	A, B
Veridian	$20 per loan	21%	180 days	50%	C, D
1st Financial FCU	$50 per loan	10%	30 days	none	A, B, C
Four Corners	$20	18%	120 days	none	B, D

Sources: http://www.ohiocreditunions.org/StretchPay/CUInfo.htm, http://www.pacreditunions.com/betterchoice.html, http://www.realsolutions.coop/assets/2009/3/24/REAL_Solutions_Payday_Loan_Toolkit_v032309.pdf.

Notes: Other restrictions include: (A) membership length requirement, (B) minimum income/employment tenure requirement, (C) internal credit check, (D) direct deposit, and (E) external credit check. An "E" indicates use of an external credit check different from that used by payday lenders (e.g., GoodMoney uses Teletrack, so it does not receive an "E").

On the high end is the ADVANCPay program operated by One Nevada Credit Union (formerly Nevada Federal Credit Union), which charges a flat fee of $70 per loan, with loan amounts up to $700. Because these data are not comprehensive, it is possible that other credit unions charge rates and fees that are either higher or lower than those in the sample shown here. But the data are representative of the range and variety of rates and fees nationally.

Comparing these terms to those of the standard payday loan is not straightforward. Total charges for a credit union payday loan will vary based on how quickly the loan is repaid. When a credit union imposes an annual fee rather than a per-loan fee, average charges per loan will fall as the number of loans taken rises. Finally, some credit unions require a "savings deposit" from the loan principal. StretchPay requires a 10 percent deposit, while Better Choice requires 5 percent. Lenders only grant borrowers access to those deposits after loan repayment, effectively reducing the loan amount by either 5 percent or 10 percent; for example, a $500 StretchPay loan actually leaves the borrower with $450 in short-term cash. The proximate effect of such savings deposits is to increase effective interest rates on credit union payday loans. For example, Veridian Credit Union holds back a full 50 percent of the loan amount, but charges interest on the entire amount; that effectively doubles the APR paid by the borrower.

In order to compare loan terms in light of these details, Table 2 chooses representative loan amounts and repayment periods, calculating the total cost of borrowing across different products. The table shows total borrowing costs for a small ($180) and large ($450) loan with two terms: two weeks and one month. For those loans with two-week terms, the latter scenario represents one "rollover" of each loan.

The table reveals that the standard payday loan compares favorably to some programs and unfavorably to others. There are no columns in which the standard payday loan is more costly in total than any credit union alternative. That stems in large part from the very high fee on the ADVANCPay loan. But for loans with smaller amounts and shorter terms, the standard payday loan beats most of the programs in terms of total borrowing cost. In particular, for the $180 loan over a two-week horizon, the standard payday loan beats three of the other programs, essentially matches one other, and is more costly than two others. Note, however, that StretchPay is by far the most common benchmark for other credit unions, and for that term the standard payday loan costs almost exactly as much as a StretchPay loan.

The patterns in Table 2 suggest one general conclusion and some specific conclusions. The general conclusion is that credit union payday loans are generally less costly than standard payday loans, but often not by much—and that sometimes they are more costly. The specific conclusions pertain to how different types of borrowers would view the alternatives. All else equal, a borrower needing a small sum for a short period of time may find the standard payday loan to be quite competitive in terms of total borrowing costs. Borrowers who need money for longer periods of time, and who would therefore roll over a series of loans, should find credit union payday loans with longer terms attractive. Among those loans, ones with annual fees rather than per-loan fees should be the best choice. Loans with annual fees rather than per-loan fees appear to be rare, however. Borrowers wishing to borrow significant sums should find attractive the credit union payday loans with per-loan fees that do not increase at higher loan amounts.

Both the tilt toward longer terms and the tilt toward higher loan amounts suggest that credit union payday loans should appeal more strongly to those borrowers in greater financial distress, who would both borrow more and roll over their loans. Borrowers in better financial shape may not be so strongly drawn to the credit union product. That raises a question: Is it reasonable to expect credit unions to compete for the more-stressed borrowers currently served by payday lenders? One might expect that credit unions inherently would attract borrowers who are more financially stable than average. Credit unions generally have lower loan default rates than commercial banks, suggesting that their customer base is less risky. Such a mismatch between products and borrowers might make it harder for credit unions to make inroads in this market. That mismatch is, of course, a function of the interest rate caps faced by credit unions because credit unions must recoup the forgone interest revenue via application fees or annual fees. If consumers find the fee structure permitted by the NCUA unattractive or complex, then it would be fair to view the NCUA interest rate ceiling as an entry deterrent for credit unions.

It is possible that credit unions might eventually construct even more innovative business models that do compete effectively. North Carolina State Employees' Credit Union (NCSECU), for example, has a salary advance program with no fees, a one-month term, and a 12 percent APR. NCSECU retains 5 percent of each loan in a savings account that grows with each loan, and access to the funds is restricted; withdrawing funds bars the customer from obtaining another advance in the subsequent six months. Both the cumulative "savings" and restricted access effectively secure the loan for high-volume borrowers. For example, a customer who has borrowed for six consecutive months stands to lose 30 percent of the loan principal from defaulting, and

Credit union payday loans are generally less costly than standard payday loans, but often not by much—and sometimes they are more costly. Borrowers needing a small sum for a short period of time may find the standard payday loan to be quite competitive in terms of total borrowing cost.

a customer who has borrowed for 12 consecutive months stands to lose 60 percent; in neither instance is the customer permitted to withdraw funds from "savings" without forgoing the opportunity to get another salary advance for six months. There is little doubt that NCSECU's program has been successful, although its competitiveness against a standard payday loan cannot be measured because North Carolina currently prohibits payday lending.

As a final observation, the relatively high level of payday loan rates and fees charged by credit unions has proven somewhat controversial. In July 2009, the National Consumer Law Center issued a sharp critique of some credit unions for offering "false payday loan 'alternatives'" that cost nearly as much as standard payday loans. The letter notes that some credit unions, "which by law have an 18 percent usury cap, add fees to manipulate the APRs." In some of their examples, the effective APR on a credit union's payday loan exceeds 400 percent (that is merely a restatement of the results in Table 2, although I prefer to compare borrowing costs rather than APRs). In the same month, the NCUA issued detailed guidelines for credit unions considering offering payday loans, with the intent of alerting credit unions to the "risks, compliance issues, and responsibilities associated with operating a payday lending program."

The discussion highlights the difficulty that credit unions face in developing a payday loan product that breaks even at prices below those charged on a standard payday loan. It also suggests that political economy may provide a partial explanation for credit unions' unwillingness to enter the market: if supervisory/regulatory authorities and consumer groups frown on payday lending, credit unions might fear that entering the market might simply spur tighter regulation or a loss of reputational capital.

TABLE 2

A Comparison of Borrowing Costs on Standard Payday Loans and Credit Union Alternatives

	$180 LOAN		$450 LOAN	
	Two weeks	One month	Two weeks	One month
Standard payday loan	$ 27.00	$ 54.00	$ 67.50	$ 135.00
Better Choice	$ 36.41	$ 37.84	$ 73.54	$ 77.09
StretchPay	$ 26.50	$ 28.00	$ 27.50	$ 30.00
ADVANCPay	$ 70.00	$ 140.00	$ 70.00	$ 140.00
GoodMoney	$ 17.82	$ 35.64	$ 44.55	$ 89.10
Rivermark	$ 16.87	$ 18.75	$ 19.69	$ 24.38
Veridian	$ 23.15	$ 26.30	$ 27.88	$ 35.75
Four Corners	$ 21.35	$ 22.70	$ 23.88	$ 26.75

Notes: Total costs include any annual or application fee and interest charges, from Table 1. Calculations assume a loan amount of $450 for all loans except StretchPay, Better Choice, and Veridian—the programs with forced saving deducted from cash proceeds. StretchPay loans are for $200/$500 before the 10% savings deposit, leaving the borrower with $180/$450 in short-term credit. Better Choice loans are for $189/$472.50 before the 5% deposit, leaving the borrower with $180/$450 in short-term credit. Veridian loans are for $360/$900 before the 50% savings deposit. ADVANCPay uses the nondirect deposit rate to provide comparability to the standard payday loan.

Qualitative Differences between Payday Lenders and Credit Unions

Apart from the terms of loans, there are substantive differences between payday advance products offered by payday lenders and credit unions. Some differences are restrictions imposed by credit unions on approval and repayment. Credit unions generally impose stricter standards for loan approval. Most credit unions require that the borrower be a member of the credit union for 60–90 days before taking a payday loan. Most credit unions deny applications from customers with late payments on other loans or who have filed for bankruptcy. Some use credit bureau information to screen out bad risks. Some require that borrowers have direct deposit of their paycheck. Many only lend to borrowers above a minimum income threshold.

These restrictions have a natural economic connection to prices. It is well known that in credit markets, firms that set lower prices (typically interest rates) compensate by rationing credit—shutting riskier borrowers out of the market. By restricting access only to long-term customers with no other delinquent accounts, the credit union uses different, and arguably better, information about creditworthiness than a commercial payday lender would have about a walk-in borrower. Using credit bureau information represents a greater investment in learning about risk compared to that made by a standard payday lender. The membership restriction, minimum income requirement, and direct deposit requirement change the set of customers who are eligible for loans, generally screening out the more distressed borrowers and keeping the less distressed borrowers.

These differences should produce lower default rates on credit union payday loans. Prospera Credit Union uses the GoodMoney program (which is quite similar to a standard payday loan), has no direct deposit or membership requirements, and only slightly more stringent approval standards; its loan loss rate is 4.6 percent. Wright-Patt requires 60-day minimum membership and a minimum monthly income of $1,300, but does not require direct deposit; its loan loss rate is 1.7 percent. Veridian Credit Union uses the same credit scoring database used by standard payday lenders, but requires direct deposit; its loss rate is 1.8 percent. Four Corners Credit Union requires direct deposit; its loss rate is 0.3 percent. By comparison, the net loss rate for payday lenders is around 4 percent.

Lower default on credit union payday loans means that a simple comparison of terms or borrowing costs cannot answer the "Are standard payday rates too high?" question. Standard payday loan rates are set to cover default risk on standard payday loans. Credit union payday loan rates must also cover default risk, but that risk is lower. Consequently, default-adjusted rates and fees at credit unions may be quite comparable to (or even more expensive than) those on standard payday loans.

Credit loans and payday lenders differ in other ways that seem subtler but may matter just as much to consumers. One difference is in application and approval times, which are generally shorter at payday lenders. Store hours at credit unions are limited relative to those at payday lenders, and are sometimes shorter than normal banking hours.

Consumer Preferences for Payday vs. Credit Union Products

To assess how important the non-price differences are, an independent survey research firm was commissioned to ask 40 current payday borrowers a series of questions about standard and credit union payday loans. The survey was conducted in a relatively high-volume location in Sacramento, Calif., on a high-volume day (Friday). Customers were selected at random and given a voucher for $25 (redeemable at the lender) in exchange for participating in the survey.

The main body of the survey began by positing a credit union payday loan with terms slightly better than those offered by the Better Choice program:

> In the next several questions, suppose that your bank or credit union offered a payday advance program that charged an 18 percent annual interest rate on each loan and a $35 annual fee (paid regardless of the number of loans).

The survey followed up by asking a series of questions comparing that loan to a standard payday loan. Each question also asked the borrower to value one other feature of the credit union product. For example, the question focusing on direct deposit asked:

> If the product had the fees/rates above but *required that the loan be repaid immediately when your paycheck was direct deposited*, and was otherwise just like a standard payday advance, would you use that product to meet short term needs for cash, or would you still prefer to use a payday lender?

The survey asked seven such questions, each varying the characteristics of the credit union product. The characteristics were:

- Direct deposit requirement
- Loans only available during normal banking hours
- Default negatively affects credit score
- 5 percent "savings deposit"
- 30-minute application and loan approval period
- No loan rollovers
- 60-day minimum membership requirement

The characteristics are simply the set of qualitative differences between standard payday loans and those offered by credit unions.

On the spectrum of prices charged by credit unions, the Better Choice product is quite attractive, meaning that any bias is probably in the direction of the credit union-like payday loan. And because it proceeds characteristic-by-characteristic, the survey also only asks borrowers to offset lower prices with one non-price benefit rather than the full set (which is presumably worth more than any one benefit). An advantage of the approach is that it elicits information about which non-price characteristics are valued most highly by borrowers.

Table 3 summarizes the survey results. For every characteristic but one, three-quarters (30/40) or more borrowers preferred a standard payday loan to a credit union payday loan. In some cases, the preference was nearly unanimous.

The survey results suggest a ranking of characteristics. The least attractive characteristics were limitations on rollovers and short operating hours. Next were longer application and approval times and reporting of default to credit bureaus. Minimum membership requirements and savings deposits were also viewed as deterrents to taking out a payday loan. The least unattractive option was payroll direct deposit. Given the small sample, the standard errors on these estimates are fairly large, but a majority of borrowers preferred the higher-priced but less restrictive choice.

The survey also asked two other questions intended to elicit information about the less tangible differences perceived by borrowers across the products. One question asked a direct question about preferred lenders for identical products:

> Suppose that your bank or credit union offered a short-term loan product that was *identical* to a standard payday loan. Would you use that product to meet short term needs for cash, or would you still prefer to use a payday lender?

This question elicited the borrower's preference for "soft" characteristics associated with each type of lender. It was followed by an attempt to understand what those soft characteristics might be:

> If you answered [that you] ... would still prefer to use a payday lender, can you explain why? Please check any reasons that apply.
> a. **Location**: my payday lender is closer to my home or work.
> b. **Hours**: Payday lenders let me obtain cash before or after normal bank business hours.
> c. **Speed**: Payday lenders are able to give me cash quickly, with-

TABLE 3

Consumer Preferences for Standard and Credit Union Payday Loans

By credit union payday loan characteristic

Characteristic	CONSUMERS PREFERRING: Bank/Credit union	Payday lender
Direct deposit requirement	33%	68%
Normal banking hours only	10%	90%
Default affects credit score	13%	88%
5% savings deposit	25%	75%
30-minute application time	18%	83%
No rollovers allowed	8%	93%
60-day membership requirement	25%	75%

Notes: Results from a survey of 40 current payday loan customers in Sacramento, Calif., in July 2009. Survey asked consumers to choose between a standard payday loan and a credit union loan with terms identical to those in the Better Choice program; the credit union loan also had the restriction listed in the "characteristic" column. With $n = 40$, the 90% confidence interval for any of the shares in the table extends +/−16%.

out spending a lot of time in the store.

d. **Privacy:** I prefer to keep my payday borrowing separate from my other banking, for personal reasons.

A majority (55 percent) of current payday borrowers said they would prefer to borrow from payday lenders even if a bank or credit union offered an identical product. That indicates that for some customers, the qualitative benefits of payday lenders are substantial. Responses to the second question indicate that the most important "soft" features of payday lenders were hours (checked by 77 percent of respondents), privacy (73 percent), speed (64 percent), and location (59 percent).

Overall, the survey results paint a fairly clear picture. The characteristics of typical credit union payday loans make those loans quite unattractive to most payday borrowers. Most payday borrowers reject a product with even one of those restrictions, even if the credit union payday loan has fees and rates that are lower than those offered by payday lenders. (The terms of the loan in the survey were less expensive than even the subsidized terms of the payday lender Better Choice program.)

Some of the unattractive features are restrictions on approval or repayment, implying that borrowers place high value on the option to default should they be unable to repay the loan. The high value that borrowers place on softer features such as hours of operation and privacy are in some sense more damaging to the credit union business model because such characteristics are inherent in credit unions. Even if credit unions decide to mimic the standard payday product as closely as possible, they might be unable to match those features.

The survey results indicate that the characteristics of typical credit union payday loans make those loans quite unattractive to most payday loan borrowers. Most of those borrowers reject a product with even one of the restrictions imposed by credit unions.

Conclusion

The best available evidence supports a view that credit unions cannot viably serve as providers of short-term credit to the customers currently served by payday lenders. Most telling, very few credit unions choose to offer payday loans even though there are few legal or regulatory obstacles to doing so. That is a convincing market test: a standard payday loan out-competes the credit union version.

What is more, there is little to suggest that credit unions can offer a payday loan with competitive terms. Existing credit union payday loans often have total borrowing costs that are quite close to those on standard payday loans. And credit union payday loans have lower default risk; risk-adjusted prices on standard payday loans may be no higher than those on credit union payday loans.

Finally, current payday borrowers strongly value the non-price benefits offered by payday lenders. Some of those benefits—such as longer operating hours and privacy—are intrinsic to the payday lender business model and would be nearly impossible for banks or credit unions to replicate.

While this article uses credit unions as the competitive benchmark, there is little reason to believe that deposit banks could be more competitive than credit unions in competing against payday lenders. Banks generally charge higher loan rates across the range of products. Evidence from the Federal Deposit Insurance Corporation's Small Dollar Loan program for banks suggests that loan rates under the program were below break-even levels for some banks. These findings suggest that expecting firms—whether they are more stringently regulated payday lenders or other unregulated financial institutions such as banks and credit unions—to provide borrowers with lower-priced but otherwise similar short-term loan products is unrealistic.

Whether denying borrowers access to such products helps or hurts them is a separate question, of course. The evidence on that point is mixed, but it shows on balance that many borrowers are helped by access to short-term credit even at prices that some observers might consider "high." In light of that work, the evidence here suggests that regulating payday lending would simply drive lenders out of the market, and that we should not expect other financial institutions to fill the void, particularly at lower prices. That would leave borrowers who benefit from access to short-term credit with fewer options, making them worse off. Any discussion of public policy in short-term loan markets must consider that downside.

READINGS

- "A Comparative Analysis of Payday Loan Customers," by Edward Lawrence and Greg Elliehausen. "*Contemporary Economic Policy*, Vol. 26 (2008).
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- "Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?" by Paige Skiba and Jeremy Tobacman. *American Economic Review Papers and Proceedings*, Vol. 99, No. 2 (2009).
- "Restricting Consumer Credit Access: Household Survey Evidence on Effects around the Oregon Rate Cap," by Jonathan Zinman. *Journal of Banking and Finance*, Vol. 34, No. 3 (2010).
- "What Do Consumers Really Pay on Their Checking and Credit Card Accounts? Explicit, Implicit, and Avoidable Costs," by Victor Stango and Jonathan Zinman. *American Economic Review Papers and Proceedings* Vol. 99, No. 2 (2009).

Payday Lending Best Practices Help Prevent So-Called "Cycle of Debt"

There is little doubt that millions of Americans need access to short-term credit. A 2007 survey by the American Payroll Association found that sixty-seven percent of American employees are living paycheck to paycheck. For these Americans, a short-term loan is one credit option that provides an important service when a family is unable to absorb unexpected expenses between paydays.

The Community Financial Services Association of America (CFSA) represents more than half of the payday advance locations nationally. Through a set of Industry Best Practices, our members provide strong consumer protections to help ensure that customers use payday advances responsibly.

Full Disclosure

- To help a consumer make an informed decision about whether to use a payday advance, loan fees and rates are displayed on a clearly visible poster (no less than 18" x 22")[1] in stores and also posted on company websites.
- CFSA members must include a customer notice that encourages responsible use of the product on all marketing materials. The notice advises "Payday advances should be used for short-term financial needs only, not as a long-term financial solution. Customers with credit difficulties should seek credit counseling."

Right to Rescind

- Customers have the right to rescind, at no cost, a payday advance transaction before the close of the following business day.

Extended Payment Plan

- We recognize that unforeseen circumstances sometimes occur between pay periods. That is why under CFSA's Best Practices, all member companies offer an **Extended Payment Plan** (EPP)[2] to any customer who cannot repay their loan when due for any reason **at no additional cost.**
- Customers who enroll in the EPP pay off the transaction balance with no additional fees in four equal payments coinciding with the borrower's periodic paydays.

[1] In all cases where applicable state regulations require additional or different information, a member shall comply with the state regulation
[2] Subject to applicable state laws and the availability of an Extended Payment Plan in your state

Payday Advance: Fact vs. Fiction

Fiction: They prey on poor, uneducated and older consumers

Fact: Payday advance customers represent the heart of the working middle class[1]

- 41% earn between $25,000 and $50,000; 39% report incomes of $40,000 or more
- More than half are under 45 years old; 63% have children at home; less than 10% are 65 or older
- 90% have a high school diploma or better, with 54% having some college or a degree
- 85% use other forms of credit; 54% have credit cards
- 100% have a steady income and an active checking account, both required for an advance

Fiction: They charge outrageous rates

Fact: Payday advance fees typically cost less than customers' alternatives

- 98% of customers are aware of the finance charge; 81% recall it being disclosed as an APR[2]
- Payday advance APRs are often lower than customers' alternatives, even on same 2-week term
  - $100 payday advance with $15 fee = 391% APR
  - $100 bounced check with $56 NSF & merchant fees = 1,449% APR
  - $100 credit card balance with $37 late fee = 965% APR
  - $100 utility bill with $46 late/reconnect fee = 1,203% APR
- FDIC study: a bank customer repaying a $66 check overdraft in two weeks would incur a 1,067% APR[3]

Fiction: They put customers into a cycle of debt

Fact: Most customers use payday advance responsibly

- 70% use payday advance to cover unexpected expenses[4]
- State regulator reports and public company filings confirm: more than 90% of payday advances are repaid when due and more than 95% are ultimately collected
- Research concludes that most use payday loans moderately
  - Financial Services Research Program study, The George Washington University School of Business: "…most customers used payday loans as a short-term source of financing."[5]
  - Public policy analysis by a Clemson University economist and The Brattle Group: "There is no statistical evidence to support the 'cycle of debt' argument often used in passing legislation against payday lending."[6]
  - Staff report by a Federal Reserve Research Officer: "Most of our findings contradict the debt trap hypothesis."[7]
  - FDIC's Center for Financial Research study: 72% of customers took out less than 12 advances per year[8]

Fiction: The typical borrower pays back $793 for a $325 payday advance

Fact: A typical customer pays $52 for a $325 payday advance

- Opponents of payday lending falsely represent the cost of an advance by counting the principal for only one loan and adding the fees for nine loans—claiming the typical customer takes out one advance and rolls it over 8 times. This scenario is impossible under state laws and industry Best Practices.
- The regulatory services company that tracks payday advance transactions for a number of state regulators reported that the opponents "misinterpreted their data to come to flawed conclusions."[9]

Fiction: They take advantage of unsuspecting customers

Fact: Across the country customers overwhelmingly appreciate the service

- Millions choose payday advance as a dignified, discreet, and often less costly solution for cash flow problems, without asking family for money or risking personal items as collateral
- 88% of customers reported being very or somewhat satisfied with their payday loan[10]
- State regulators report very few complaints out of millions of transactions

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[1] "*An Analysis of Consumers' Use of Payday Loans*," by Gregory Elliehausen, Division of Research and Statistics, Board of Governors of the Federal Reserve System and Financial Services Research Program, The George Washington University School of Business, January 2009
[2] IBID
[3] "*FDIC Study of Bank Overdraft Programs*," Federal Deposit Insurance Corporation, November 2008
[4] Elliehausen, op. cit.
[5] IBID
[6] "*Restriction on Credit: A Public Policy Analysis of Payday Lending*," Petru S. Stoianovici of The Brattle Group and Michael T. Maloney, PhD of Clemson University, October 2008
[7] "*Payday Holiday: How Households Fare after Payday Credit Bans*," by Donald Morgan, Federal Reserve Bank of New York, November 2007
[8] "*Payday Lending: Do the Costs Justify the Price?*", FDIC's Center for Financial Research, By Mark Flannery and Katherine Samolyk, September 2005
[9] "*White Paper Analysis of CRL Report: Financial Quicksand*," Veritec Solutions, LLC, January 2007
[10] Ellihausen, op. cit.

Prepared by: CFSA

Payday Lenders Provide Desired Service to Lower and Moderate Income, Middle-Educated, Young American Families

"*An analysis of Consumers' Use of Payday Loans*" by Gregory Elliehausen, Division of Research and Statistics, Board of Governors of the Federal Reserve System and Financial Services Research Program, The George Washington University School of Business, describes the demographic characteristics of payday loan customers and considers whether they make rational decisions and if they benefit from access to credit.

Elliehausen notes that only 2% of U.S. adults use payday loans at any one time and provides a detailed picture of the typical payday loan customer, including who they are, how they use the service and their decision-making process.

According to the monograph, customers that use payday loans:

- Skew young; 63% have children at home
- Have lower and middle incomes; 41% earn between $25,000 and $50,000; 39% report incomes of $40,000 or more
- Are educated; 90% have a high school diploma or better, with 54% having some college or a degree
- Have limited liquid assets and savings, most use other forms of credit
- Have characteristics that may limit their access to credit
- Use payday loans moderately, as intended for short-term use
- Are aware of the cost of their most recent payday loan
- Consider the alternatives, are satisfied with their decision
- Benefit by having access to payday loans

Elliehausen concludes that, "Most payday loans are used to pay unexpected expenses or expenses that could not be postponed…If payday loan customers live from paycheck to paycheck with very little discretionary income, even small expenses may cause financial problems and make emergencies a frequent event. In such cases, even frequent use of payday loans may be better than the alternatives."

Full monograph available at http://www.business.gwu.edu/research/centers/fsrp/pdf/m41.pdf.

- **Customers skew young; 63% have children at home**

"By far, most payday loan customers were in younger age groups, which tend to use relatively large amounts of credit. Most payday loan customers were less than 45 years of age in 2007, and three-fourths were less than 55."

"Ten percent of payday loan customers were 65 years or older. This percentage is considerably less than the 19.9 percent of all consumers who were 65 years or older."

"…More than half (62.7 percent) of payday loan customers were from families with children."

➢ **Customers have lower and moderate incomes**

"Payday loan customers largely do not have profiles similar to the typical fringe banking customer...The requirement that customers have a checking account prevents many low-income consumers from qualifying for a payday loan."

"A large percentage of payday loan customers had higher incomes. Thirty-nine percent of payday loan customers had incomes of $40,000 or more, about a quarter had incomes of $50,000 or more, and 8.9 percent had incomes of $75,000 or more."

"...It is notable that the higher income customers (income ≥ $50,000) are a larger share of payday loan customers than lower income (income < $15,000) customers."

➢ **Customers are educated; 90% have high school diploma or better**

"Almost all payday loan customers had a high school diploma or higher education, but customers were concentrated in the middle levels of educational attainment."

"Payday loan companies do not draw heavily on consumers from the lowest and highest education attainment groups."

➢ **Customers have limited liquid assets and savings**

"Payday loan customers' liquid assets are quite limited. Fewer than half (44.7 percent) of payday loan customers reported having savings or reserve funds in 2007...The size of most payday loans [$315] suggests that customers' checking and savings balances could not have been very large."

"Most payday loan customers did not save regularly. Thirty-six percent of customers reported spending all the income that they receive, and 33.4 percent reported saving whatever was left over at the end of the month. Just 29.0 percent of payday loan customers said that they regularly set aside money for savings."

➢ **Nearly all customers use other forms of credit, but may have limited access**

"Eighty-five percent of customers used other types of consumer credit in 2007."

"...Payday loan borrowers were less likely to have open-end credit than all consumers. Fifty-four percent of payday loan customers had a bank credit card, compared to 74.5 percent of all consumers; and 21.7 percent of payday loan customers had a retail credit card, compared to 50.4 percent of all consumers.

"Fifty-five percent of payday loan customers experienced credit limitations in the previous five years. An even higher percentage of customers considered applying for credit but did not because they thought that they would be denied."

"Many more consumers are credit constrained than use payday loans. According to the Survey of Consumer Finances, 25.7 percent of consumers had incomes less than $50,000 and were under 45 years of age or unmarried with children. Nearly half of these consumers in the last five years had been turned down or did not apply for credit because they thought they would be turned down. Thus, being credit constrained does not by itself appear to be sufficient to cause consumers to turn to payday loans."

- **Customers use payday loans moderately, for short-term use to deal with unexpected expenses**

"The stimulus by far for most payday loans was an unexpected expense or an expense that could not be postponed. Seventy percent of payday loan customers agreed strongly with the statement "I had an unexpected expense that could not be postponed." Forty-seven percent agreed strongly with the statement "I knew that an expense was coming but did not have the cash when the expense was due."

"The survey evidence indicates that most customers used payday loans as a short-term source of financing. They used payday advances a small or moderate number of times during the past year, typically for less than a month at a time...Such use seems consistent with the intended purpose of payday loans as short-term borrowing to pay unexpected expenses or relieve temporary shortfalls in income."

"Frequent use is not necessarily evidence of a debt trap, however. If payday loan customers live from paycheck to paycheck with very little discretionary income, even small expenses may cause financial problems and make emergencies a frequent event. In such cases, even frequent use of payday loans may be better than the alternatives."

"Most payday loan customers had relatively short sequences of consecutive loans (which include a new loan and subsequent renewals). Thirty-five percent of customers reported that their longest sequence was two weeks or less. Another 29.4 percent reported longest sequences between 3 and 4 weeks."

"Few payday loan customers considered payday loans as a debt trap. Only about three percent of payday loan customers mentioned difficulty of getting out of debt as a reason for being dissatisfied or only partially satisfied with their most recent new payday loan."

- **Customers are aware of the cost of their most recent payday loan**

"...nearly all payday advance customers are aware of the finance charges for their most recent new payday advance. That customers are aware of the finance charge suggests that this measure of cost is useful and relevant to them. They can readily compare the finance charge for a payday loan with a dollar amount of savings or avoided costs from use of a payday loan to make a decision."

"Payday loans are a simple product. Price is the key term. Payday loan customers receive two price disclosures, the finance charge and annual percentage rate. Truth in Lending requires disclosures of these two prices. Customers likely would be aware of the finance charge regardless of regulation since the finance charge is the difference between the amount of the check and the amount of cash they receive."

"Eighty-one percent of payday loan customers recalled receiving information on the annual percentage rate for their most recent new payday loan, but far fewer customers were able to recall the actual annual percentage rate...That most payday loan customers are not aware of the annual percentage rates suggests that they may not have found the annual percentage rate very useful in their most recent decision. Penalties, late fees, or other costs that customers save through use of payday loans are not normally expressed as annualized percentages."

- **Customers consider the alternatives, deliberate, and are satisfied with their decision**

"Nearly half [46.4 percent] considered other sources of credit before obtaining a payday loan. The most frequent other source was a friend or relative, but a bank, finance company, or credit union were also frequently mentioned.

"Despite the urgency, the small size of the loan relative to income, and perception that few alternatives were available, many payday loan customers showed signs of deliberation in their decisions."

"...overall, 50.6 percent of customers reported believing that a payday loan was their only choice at the time they obtained their most recent new payday loan."

"Many customers perceived that they had few options to payday loans. Less than one-fifth of customers had sufficient funds in a checking and savings account. Customers frequently either did not have a credit card or if they had a credit card would have exceeded their credit limit. A considerable percentage of customers believed that they could have borrowed from a friend or relative."

"Nearly all payday loan customers said that they were satisfied or somewhat satisfied with their most recent new payday loan. Receiving the funds quickly, the easy loan process, and courteous treatment accounted for by far most reasons for satisfaction."

- **Customers benefit by having access to payday loans**

"By far most customers agree that payday loan companies provide a useful service to consumers (86 percent) and that most people are satisfied in their dealings with payday loan companies (75.8 percent)."

"Fifty-nine percent of customers disagreed that the government should limit the number of payday loans they can get in a year."

"...The predominant users of payday loans are consumers that economic theory predicts are most likely to benefit from high-price consumer credit."

"Payday loans may be a transitional product for many consumers: As families age and income rises, consumers may become less vulnerable to financial distress."

"In giving consumers access to additional credit for unexpected expenses or shortfalls in income, payday loans give the consumers a little control over their financial situations that they otherwise would not have."

Payday Loans in the State of California

- To Get A Payday Advance You Must Have The Following:
  - A checking account (proof of your checking account)
  - Two valid forms of identification (generally a drivers' license or ID and an utility bill)
  - A job or steady income (with two recent paystubs)

- A payday loan is a flat fee per transaction product.
  - **California law mandates:**
    - Stores can charge NO more than 15% of the face amount of the check. The maximum loan of $255 plus the $45 fee equals a total of $300.
    - There are NO accruing interest charges and NO late fees.
    - It is illegal to charge any more than the initial fee.

- How are payday loans regulated?
  - Payday loan companies are regulated by the Department of Corporations (DOC) and are subject to audits.
  - Every payday loan store is individually licensed and must abide by federal, state, county and city laws.
  - State law governs payday loan terms, fees, and consumer protection.

- In the State of California ...
  - The vast majority of customers pay back their loan, on time, in two weeks.
  - The average customer earns approximately $55,000/year and more than half own a home.
  - It is illegal to 'rollover' a loan - a customer cannot take out a new loan to pay off an existing one.
  - Payday loan companies are regulated by the Department of Corporations (DOC) and are subject to auditors by the DOC every two years

- APR vs. Fee-based Product: (*Federal Truth and Lending Guidelines*) The industry is mandated by the federal government to display Annual Percentage Rate (APR).
  - Though this is only a two-week loan, if amortized (one took out this loan every two weeks for an entire year), it would amount to 391 percent.
  - Under California law, payday lenders are only allowed to charge a one-time upfront fee for a transaction. Compounding interest or late fees are NOT allowed.

- Payday advance compares favorably to many consumer alternatives, even when expressed as annual percentage rates for two-week terms:
  - $100 payday advance with $15 fee is 391% APR.;
  - $100 bounced check with $54.87 NSF/merchant fee is 1431% APR;
  - $100 credit card balance with $37 late fee is 965% APR;
  - $100 utility bill with $46.16 late/reconnect fees is 1203% APR;
  - $100 off-shore Internet payday advance with $25 fee is 651.79% APR;
  - $29 overdraft fee on $100 is 755%.

- How Do Payday Lenders Compare As Employers?
  - The entry-level employee makes between $10-15/hour - offering employees full medical insurance and 401k options.

Why Payday Advance is Not Predatory Lending

The term "predatory lending" has received a lot of attention; but its definition is unclear and the distinction between predatory lending and subprime lending is blurred. This vagueness of the term has been used to portray certain financial services inaccurately. Payday advance has been the target of just such an attempt, and it is clearly unwarranted.

In general, predatory lending is defined as a harmful form of subprime lending in which consumers are pressured to take loans they don't need, putting valuable assets at risk. Federal Reserve Governor Edward Gramlich said in an address to the Texas Association of Bank Counsel 27th Annual Convention at South Padre Island on October 9, 2003 that predatory lending typically involves at least one, and perhaps all three, of the elements listed below. **Not one** of these elements applies to payday advance and here's why.

Three Elements of Predatory Lending, according to Federal Reserve Governor Gramlich:

- 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").
- Engaging in fraud or deception to conceal the true nature of the loan obligation from an unsuspecting or unsophisticated borrower.

Why Payday Advance is NOT Predatory Lending:

- Payday advance is a small denomination, un-collateralized, unsecured short-term financial transaction based on the borrower's steady income.
- Most state laws prohibit the extension of a payday advance by paying an additional fee (rollover). CFSA members do not encourage rollovers and, in states where rollovers are permitted, limit them to 4 or the state limit, whichever is less.
- The cost of a payday advance is fully disclosed to customers on signage and in disclosure agreements. Terms and fees are simple and transparent. There's a one-time, flat fee with no hidden charges, balloon payments or accruing interest.

  CFSA members also provide an educational brochure emphasizing responsible use of the product and offer a free right of rescission should the customer change his mind.

  Research shows customers are middle-income and educated; 92% believe payday advance is a useful service; 96% are aware of the cost and how it compares to alternatives.