Submitted by:
Dart Johnson
MontPIRG
EXHIBIT 2
DATE 1-15-07
HB 29

Financial Quicksand:

Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year

Uriah King, Leslie Parrish and Ozlem Tanik
Center for Responsible Lending

November 30, 2006

CENTER FOR RESPONSIBLE LENDING

www.responsiblelending.org

TABLE OF CONTENTS

Executive Summary 2

Background 3

Discussion of Findings 6

Conclusion 13

Appendix 1 14
Appendix 2 17
Appendix 3 23
Notes 25

I. EXECUTIVE SUMMARY

America's working families pay billions of dollars in excessive fees every year, as payday lenders across the nation routinely flip small cash advances into long-term, high-cost loans with annual interest rates in the range of 400 percent.

Despite attempts to reform payday lending, now an industry exceeding $28 billion a year, lenders still collect 90 percent of their revenue from borrowers who cannot pay off their loans when due, rather than from one-time users dealing with short-term financial emergencies.

Based on data collected by state regulators, financial records released by payday lenders, and assessments by third-party analysts, we update here our 2003 quantification of the cost of predatory payday lending to American families. Breaking down the impact by state, we also calculate the savings to families in states that have banned payday lending.

In this report, we find that:

- Ninety percent (90%) of payday lending revenues are based on fees stripped from trapped borrowers, virtually unchanged from our 2003 findings. The typical payday borrower pays back $793 for a $325 loan.
- Predatory payday lending now costs American families $4.2 billion per year in excessive fees.
- States that ban payday lending save their citizens an estimated $1.4 billion in predatory payday lending fees every year.

II. BACKGROUND

In the late 1990's, observers began to note the swift rise of an industry that marketed loans to working families at annual percentage rates (APRs) of interest that were previously unheard of in the conventional market. Payday lenders were offering what they described as short-term cash advances on their customer's next paycheck for fees starting around $15 per $100 borrowed.[1] This product was revealed to be a loan carrying APRs that generally ranged from 391 percent to 443 percent.[2]

Researchers soon found additional cause for concern: the loans are structured so that borrowers routinely have difficulty paying them off when they are due. By requiring full repayment within a short period of time (generally two weeks), with no option to make payments in installments, lenders compel payday borrowers to return again and again, renewing a loan for another large fee without being able to pay down the principal. This loan flipping is the foundation of the payday lending business model.

The payday lending industry's growth is based on their success in getting the practice of loan flipping legalized in one state after another.

Even as the abusive nature of the payday loan product has become clear, the industry continues to grow at a significant pace. From our analysis based on state regulator data, we conclude that payday loan volume is at least $28 billion a year,[3] growing by well over 100 percent over the past 5 years.[4] The payday lending industry's growth is based on their success in getting the practice of loan flipping legalized in one state after another.[5]

Loan flipping creates the payday lending debt trap

In 2002, several studies documented the incidence of payday loan flipping, including one by a University of North Carolina professor and his associate, who found that payday borrowers frequently renew loans that are marketed as short-term advances on their paychecks. This and other studies found that the payday lending industry relies on a business model that encourages this chronic borrowing.[6]

A 2003 report by the Center for Responsible Lending, "Quantifying the Economic Cost of Predatory Payday Lending," corroborated these studies, finding that the one-time two-week loan that payday lenders market is virtually nonexistent.[7] In the report, we found that only one percent of payday loans go to borrowers who take out one loan per year and walk away free and clear after paying it off. Our analysis found that the industry relies almost entirely on revenue from borrowers caught in a debt trap; ninety-one percent of payday loans go to borrowers with five or more loan transactions per year.

The data show that payday loans are, in fact, designed to be renewed. Contrary to prudent lending practices, payday lenders do not make loans based on the borrower's ability to repay. Borrowers need only a checking account and a pay stub verifying employment to qualify for a payday loan, which averages about $300.[8] The loans are secured by the borrower's signed personal check, which is dated on the borrower's next payday. The lender may submit this "live" check to the bank for payment should the borrower default. But most borrowers are unable to pay the loan back in full when it is due and still have enough cash to make it to their next payday.

The prospect of bouncing the check left in the hands of the lender, often accompanied by fear of criminal prosecution for writing a "bad check," puts tremendous pressure on the borrower to avoid default. So the borrower generally pays another fee, typically $50 on a $300 loan, to renew or float the loan for another pay period. This transaction is called a rollover.

Only one percent of payday loans go to borrowers who take out one loan per year and walk away free and clear after paying it off.

Or the lender may close out the loan and reopen it in short order to the same effect, called a back-to-back transaction.[9] Back-to-back transactions and rollovers cost the borrower exactly the same amount, typically $50 every payday until they can pay off the loan in full and walk away. However, back-to-back transactions can be particularly confusing for the borrower. Though they have to repay the first loan before taking out the second loan, the second loan can seem like "new money" since they walk out with cash in their pocket like the first time. In reality, they are borrowing back their own money minus the fee, still paying $50 every payday to keep from defaulting on their $300 loan.

However renewals are accomplished, over time the borrower finds it harder to pay off the loan principal for good as fees are stripped from their earnings every payday. They are frequently trapped paying this interest for months or even years, and many go to a second or third payday lender in an often fruitless attempt to escape the trap.[10] The process of loan flipping creates the long-term cycle we call the debt trap.

Shifts in the political landscape

By obscuring the long-term nature of their loans, payday lenders were initially successful in convincing state legislators to exempt their product from existing small loan laws.[11] Many states have annual interest rate caps of 36 percent or less for small loans, but have authorized rates ten times higher for payday loans on the grounds that these are emergency two-week loans, not long-term obligations.[12]

Many states have annual interest rate caps of 36 percent or less for small loans but have authorized rates ten times higher for payday loans.

Other states recognized the defective nature of the payday loan product and refused to grant payday lenders exemptions from small loan laws, prompting some payday lenders to disguise their loans as other products in order to continue illegal lending practices.[13]

By far the most pervasive method payday lenders have used to circumvent state lending laws is what they call the agency model, also known as "rent-a-bank." Under this arrangement, large payday lending companies typically partner with very small banks located in states with lenient lending laws. The payday lenders claim that their association with the partner bank allows them to preempt state law and make payday loans in states where they would otherwise be illegal.[14]

As rent-a-bank came to the attention of federal regulators, the regulators began clamping down on their banks and disallowing these partnerships. The Office of the Comptroller of the Currency, which regulates national banks, the Office of Thrift Supervision, which regulates federal thrifts, and

the Federal Reserve Board, which regulates member state-chartered banks, all prohibited the banks they supervise from partnering with payday lenders to make loans. However, the payday lending companies found willing partners in a handful of small state banks whose federal supervisor was the Federal Deposit Insurance Corporation (FDIC). Payday lenders used this conduit for a number of years to make loans in states that banned the product.[15]

As regulators have, one-by-one, prohibited rent-a-bank partnerships, payday lenders have lost their means of operating in states where their business is not authorized. This puts increased pressure on state legislatures.

In March of 2005, the FDIC issued new guidelines regarding payday lending for the banks they regulate.[16] The new requirements prevented banks from participating in payday lender practices that convert short-term loans into very high-cost long-term debt. The guidelines enforced limits of six payday loans per year per borrower, after which the bank would be required to offer a longer-term loan. The March 2005 guidelines and additional FDIC guidance over the past year have prompted almost all FDIC-regulated banks to end their partnerships with payday lenders.

A strong anti-payday lending law, which included a ban against rent-a-bank lending, passed into law in Georgia in 2004. It was upheld in federal court in 2006.[17] In North Carolina, payday lenders had been operating under these rent-a-bank arrangements since the state legislature let the payday authorization law sunset in 2001. The Commissioner of Banks ruled the partnerships illegal and, in December 2005, ordered Advance America to stop their payday lending in the state. Since that time, all the other major payday chains have agreed to leave North Carolina as well, under consent agreements with the state Attorney General.[18]

As regulators have, one-by-one, prohibited rent-a-bank partnerships, payday lenders have lost their means of operating in states where their business is not authorized. To our knowledge, almost all banks that had been long-time participants in rent-a-bank partnerships have severed their ties with national payday lending chains. This puts increased pressure on state legislatures in states that do not exempt payday lending from their small loan laws, as the industry continues its intense lobbying.[19]

Since CRL's 2003 report, several states have attempted to reform payday lending, a few have banned the practice altogether, and a few more have authorized it. As it stands, eleven states are free from payday lending.

New opportunities for analysis

Several state regulators have begun collecting information from payday lenders operating in their states, including the number of loans per borrower, and have made the data available to the public. Also since our 2003 report, payday lending companies have continued to consolidate into a handful of national chains, and two of these lenders have converted to publicly-held companies. The financial reports filed by these companies provide new details about the payday lending business, including the incidence of repeat borrowing by their customers. And finally, third-party financial analysts have offered more sophisticated assessments of the industry as they have accumulated additional data.

This expanding data from a range of sources allow us to update our 2003 report to capture the current cost of predatory payday lending nationwide and to break down the impact of payday lending by state.

III. DISCUSSION OF FINDINGS

Finding #1: Ninety percent (90%) of payday lending revenues are based on fees stripped from trapped borrowers, virtually unchanged from our 2003 findings. The typical payday borrower pays back $793 for a $325 loan.

New information from data provided by state regulators, payday lenders' public filings, and assessments of third-party industry analysts confirms the payday lending industry's continued reliance on loan flipping. This information verifies the finding in our 2003 report that nearly all of payday lending revenues are based on fees collected from trapped borrowers.

State regulator data corroborates high levels of loan flipping

Five states have recently begun collecting information about payday lending activities. Our analysis of data from the four states that have released the relevant information reveals a trend quite similar to our 2003 finding that 91 percent of payday loans are made to borrowers with five or more transactions per year.[20]

Table 1. Percentage (rounded) of payday loans going to borrowers with high numbers of loans, from state regulator data

	Loans to borrowers with 5 or more transactions per year	Loans to borrowers with 12 or more transactions per year
CRL 2003 findings	91%	62%
Washington State[21]	90%	58%
Florida[22] (one-loan at a time limit)	89%	57%
Oklahoma[23]	91%	66%
Colorado[24]	Not Available	65%
2005 Average	90%	62%

Washington State provides a detailed breakdown of the number of loans to borrowers in a year. Similar to the finding of our 2003 study, in the state of Washington, 90 percent of loans go to borrowers with five or more transactions per year. (See Appendix 1 for detailed data from Washington State and our calculations.)

Oklahoma limits borrowers to two payday loans outstanding at any one time,[25] and in spite of that attempt to control repeat borrowing, 91 percent of Oklahoma's payday loans also go to borrowers with five or more transactions per year—again, the same as our 2003 study figures.

Florida limits borrowers to a single loan outstanding at any one time from any lender. In this state, 89 percent of loans go to borrowers with five or more transactions per year and 57 percent go to borrowers with 12 or more loans per year. The single loan outstanding rule may be why the rate of repeat borrowing is slightly lower in Florida than in other states, but the difference is not significant.

We also found that the number of loans going to borrowers with 12 or more transactions per year, based on the four states that report those figures, comes to an average 61.5 percent (rounded up to 62% in Table 1). This is what we found in our 2003 study—that 61.5 percent of payday loans went to borrowers who had 12 or more loans per year.[26]

Regulator data and payday lenders' public filings confirm that most borrowers renew payday loans many times per year

The average number of loans reported by various sources confirms that payday borrowers are not using this product as an occasional emergency loan, but rather are trapped in the loan and routinely pay more in fees than they originally borrowed. Based on these averages, the typical borrower has nine loan transactions per year from a single payday loan store. (See Table 2.)

Table 2. Average number of payday loans per borrower from state regulator data

	Average Annual Loans per Borrower*
California[27]	6
Colorado	9
Florida	8
Iowa[28]	12
Oklahoma	9
Oregon	9
Virginia[29]	8
Washington	8
Average	9

*Florida and Oklahoma data account for multi-shop use.

The average number of loans reported by various sources also confirms that payday borrowers are not using this product as an occasional emergency loan, but rather are trapped in the loan and routinely pay more in fees than they originally borrowed.

Advance America and QC Holdings, two of the nation's largest payday lenders, offered their stock for sale to the public in 2004, and are now required to file reports with the Securities and Exchange Commission.[30] Both companies reported an average loan transaction per borrower that reveals typical long-term use of their products. Advance America reported an average of eight loans per customer per year for 2005, and QC Holdings reported an average of seven per year. CompuCredit, another major payday lender, responded to a questionnaire conducted by the University of Massachusetts Isenberg School of Management by indicating that their average payday customer uses the product seven times a year.[31]

These company figures represent the average number of loans their borrowers take from a single company. Many borrowers go to more than one payday lender. Even without accounting for this multi-shop use, with these averages it is clear that payday borrowers are routinely caught in long-term debt, making many high interest-only payments on one small loan.

Taking the interest on the average payday loan principal as reported by state regulators, and multiplying it by the average number of loan flips per year, we find that the typical borrower ends up paying back $793 for a $325 loan. (See Table 3.)

Table 3. Average principal and interest paid back on payday loan

Average principal (from state regulator data):	$325
Typical fee for $325 loan:	$52
Average transactions per year:	9
Total interest for original loan + 8 flips	$468
Total principal plus interest paid:	$793

"At a 300% APR, the interest on a payday advance would exceed the principal after about 4 months. In these circumstances, the loan starts to look counterproductive: rather than bridging a gap in income, the payday advance may contribute to real financial distress."

Morgan Stanley

Academics and industry analysts recognize the problem of loan flipping

Academics and industry observers have reached consensus on the debt trap in recent years, consistently recognizing payday lending as a practice of proffering high-cost long-term debt rather than short-term cash advances.[32]

A stock analyst at Morgan Stanley acknowledged the dependence of the payday lending industry on trapped borrowers:

"The Georgetown study reveals the long-term nature of much payday lending... At a 300% APR, the interest on a payday advance would exceed the principal after about 4 months. In these circumstances, the loan starts to look counterproductive: rather than bridging a gap in income, the payday advance may contribute to real financial distress...Advance America's disclosures show that repeat borrowing is important."[33]

Since CRL's 2003 report, two additional studies have made significant contributions in documenting that loan flipping is critical to the industry.

Ernst & Young published a report based on data from nineteen Canadian payday lending companies with 474 stores totaling $830 million in loan transactions. They found that first-time loans are twice as costly for the lenders as the cost of all loans averaged together, because of the extra time and effort required to process new customers. Ernst & Young reached this conclusion: "The survival of payday loan operators depends on establishing and maintaining a substantial repeat customer base."[34]

Another important piece of research on the subject was published last year. The FDIC's Center for Financial Research undertook a study of the industry based on payday lenders' proprietary data.[35] In the course of evaluating payday loan prices, the researchers found that the profitability of payday lending is driven by volume, which is in turn driven by rollovers.[36] The FDIC report acknowledges this dependence repeatedly: "We find that high-frequency borrowers account for a disproportionate share of a payday store's loans and profits."[37]

Payday lenders appear to compete by locking in customers

Researchers also point out features of the payday lending business that suggest the strong tendency to compete for trapped borrowers rather than to seek high numbers of occasional customers. Rather than lowering prices across the board—the fees they charge—to win higher numbers of borrowers, the payday lenders compete by sometimes lowering the price on the first loan alone, thereby luring the borrower into long-term debt, according to an analysis of the Colorado payday lending law.[38]

Other than occasional promotional cheaper first loans, payday lenders typically charge fees as high as legally permissible. As the FDIC report says, "consistent with Stegman and Faris (2003), we find that payday advance stores tend to charge an effective APR near the applicable statutory limit."[39] The Colorado report also found that 93 percent of all loans are priced at the maximum permissible amount.[40]

Indeed, the fees charged by major payday lenders have remained steady, even as markets have become saturated with payday lenders.[41] The public SEC filings of Advance America reveal that their fee remained flat at 16 percent of the loan amount even in saturated states.[42] For QC Holdings, the fee remained flat at 15 percent from 2003 to 2005.[43]

Most businesses legitimately attempt to foster customer loyalty, but the payday business is different. Customers are not borrowing repeatedly out of loyalty; instead, they are forced to stay with one lender because they cannot afford to pay off the loan. The lender is not providing any additional value to the customer with additional transactions; the lender is simply receiving additional fees to keep the same amount of principal outstanding.

Finding #2: Predatory payday lending now costs American families $4.2 billion per year in excessive fees.

In defining predatory payday lending, we consider borrowers who have had five loans per year or more to be caught in a cycle of debt. A borrower facing financial trouble will rarely be able to resolve their problem in two weeks and pay off their loan in full. Most borrowers need several months, perhaps a year, to make up a serious financial shortfall.

If we assume borrowers need a minimum of 90 days to straighten out their finances and pay back an emergency loan, then that borrower should receive no more than four legitimate emergency loans per year, one every 90 days. For purposes of analysis, we therefore assume that the fees paid on the first four loans that a borrower receives in a year are legitimate and not abusive.

To quantify the cost of predatory payday lending in our 2003 report, we first multiplied the loan volume of the industry, which was estimated by industry analysts at $25 billion, by the typical fee, which was 15 percent, to determine total fees paid. We then multiplied the total fees times the percentage of predatory loans, which was 91 percent, to get an annual cost of predatory payday lending of $3.4 billion.[44]

To update our quantification of the cost of predatory payday lending, we apply a similar methodology while using more precise information now available from many state regulators to provide a basis for estimating costs in each state.

Using our conservative methodology, we estimate that predatory payday lending now costs American families $4.2 billion per year.

(See Table 4 for a breakdown of the costs for each state. See Appendix 2 for a breakdown of the number of payday loan stores, total state loan volume, interest, total payday loan fees, percentage of predatory loans, and total predatory costs for each state.)

Table 4. 2005 Cost of Predatory Payday Lending by State

State	2005 Cost of Predatory Payday Lending	State	2005 Cost of Predatory Payday Lending
Alabama	$225 million	Nebraska	$20 million
Alaska	$4 million	Nevada	$108 million
Arizona	$139 million	New Hampshire	$5 million
Arkansas	$25 million	New Mexico	$27 million
California	$365 million	North Carolina*	$74 million
Colorado	$76 million	North Dakota	$6 million
DC	$3 million	Ohio	$209 million
Delaware	$23 million	Oklahoma	$38 million
Florida	$156 million	Oregon	$51 million
Hawaii	$3 million	Pennsylvania*	$29 million
Idaho	$26 million	Rhode Island	$3 million
Illinois	$219 million	South Carolina	$186 million
Indiana	$51 million	South Dakota	$87 million
Iowa	$40 million	Tennessee	$133 million
Kansas	$30 million	Texas	$259 million
Kentucky	$131 million	Utah	$69 million
Louisiana	$311 million	Virginia	$160 million
Michigan	$120 million	Washington	$155 million
Minnesota	$4 million	Wisconsin	$124 million
Mississippi	$135 million	Wyoming	$10 million
Missouri	$317 million		
Montana	$8 million	Total	$4.2 billion

*Rent-a-bank payday lending stores in North Carolina and Pennsylvania have closed, so these two states are expected to eliminate the costs of predatory payday lending for their citizens in 2006. The savings projected for North Carolina and Pennsylvania (see Table 5) are significantly higher than the cost figures included in this table. Cost figures are based on the actual number of payday shops in each state. North Carolina and Pennsylvania have had a small number of payday shops relative to population since payday lending is not authorized in these states. Savings figures are based on the number of shops one would expect in an authorizing state with a mature payday market.

Our findings are conservative and underestimate the cost of predatory payday lending

In quantifying the cost of predatory payday lending, we used conservative assumptions at each step in the process, in order to provide a reliable lower-end estimate. In doing so, we recognize that we underestimate the cost of predatory payday lending to American families.

We could have chosen to count all payday fees, not just those for loans going to borrowers who had five or more loans per year. Payday loans carry triple-digit interest rates, demand full payment in a short period of time, and use the high-pressure collection tactic of allowing the lender to hold the borrower's signed, personal check. With just four loans per year, a borrower typically pays $200 in interest for a $300 revolving loan.[45] Most consumer advocates consider all payday loans inherently predatory because of these terms.

In addition, we assume that borrowers take only one additional loan from each additional shop they use, and that borrowers go to a maximum of only four shops. (In reality, many borrowers take more than one loan from each additional shop—some borrowers go to more than four shops.)

Finally, our estimates of the number of stores in each state include rent-a-bank and licensed stores, but do not include subterfuge shops or Internet lending. Subterfuge shops illegally make payday loans by disguising them as other products.[46]

We assumed 177 stores were located in Arkansas. A recent report estimates, though, that there were a total of 275 stores, including rent-a-bank, licensees and subterfuge payday shops. If we had assumed 275 stores in Arkansas instead of 177 in our calculations, the cost of predatory payday lending to Arkansas families would increase to $38 million from $25 million.[47]

Finding #3: States that ban payday lending save their citizens an estimated $1.4 billion in predatory payday lending fees every year.

Despite the spread of payday lending nationwide, a number of states have no known costs associated with the practice. These are states where bans on payday lending were enforced in 2005 with the end of rent-a-bank lending. These states frequently withstood enormous lobbying pressure from the industry to maintain their consumer protections and usury limits.

North Carolina will join those "safe" states for 2006, having recently taken action to eliminate payday lending within its borders, as will Pennsylvania, which had primarily rent-a-bank payday lenders operating within its state until last year. Including these two states, we project the 2006 savings for states that ban payday lending at $1.4 billion, quite a significant level considering that these total savings are realized by fewer than a dozen states. (See Table 5 for the projected 2006 savings in payday lending "safe" states. See Appendix 3 for the calculations.)

Table 5: Projected Savings for 2006 in States That Have Enforced Bans Against Payday Lending

State	2006 Savings
Connecticut	$64 million
Georgia	$147 million
Maine	$25 million
Maryland	$97 million
Massachusetts	$119 million
New Jersey	$150 million
New York	$345 million
North Carolina*	$153 million
Pennsylvania	$234 million
Vermont	$12 million
West Virginia	$36 million
Total	$1.4 billion

The 2006 savings for states that ban payday lending is $1.4 billion, quite a significant level considering that these total savings are realized by fewer than a dozen states.

*The actual 2006 North Carolina savings might be slightly less since three payday chains continued making loans through late February and early March, prior to the effective date of their consent agreements with the North Carolina Attorney General. The figure in Table 5 conservatively projects the savings for all future years.

Arkansas presents a unique case in our analysis of the costs of payday lending. Arkansas has an interest rate cap in its Constitution of 17 percent that applies to small loans; in effect this makes Arkansas a state that bans payday lending. Arkansas had about 80 stores operating under the rent-a-bank model until recent FDIC action either shut them down or forced those lenders to find alternative means to make payday loans in Arkansas. Additionally, the state currently has about 177 payday lending stores that operate as Arkansas licensees. These licenses were issued under a payday lending authorization law that is in clear conflict with the Constitutional usury cap. As of the publication of this paper, these stores had not been shut down.[48]

In keeping with our conservative analysis, we have omitted Arkansas from the projected savings table for 2006.

IV. CONCLUSION

Solving the payday lending problem has been a huge challenge for most states. The industry has successfully lobbied legislatures across the country to exempt payday lending from state consumer loan laws. In addition to legalizing the practice of holding a live check as collateral, these exemptions typically authorize interest rates at ten times the interest rate cap provided for in the state's consumer loan laws.

But there are signs that the tide is turning. The wave of payday authorization has clearly slowed, with states increasingly wary of this loan product. Several states have either refused to exempt payday lending from their laws or have closed existing loopholes.

Since the FDIC recognized the abusive nature of payday lending and tightened the reins on the banks they insure, the practice of national payday companies partnering with out-of-state banks has all but disappeared. This places the responsibility for preventing predatory payday lending squarely in the hands of state legislators in the states where it is currently legal.

Some states have tried to reform payday lending by requiring databases, cooling-off periods, repayment plans or limits to the number of outstanding loans. The payday lending industry generally endorses these reforms, though we have found in the analysis provided in this paper that they have little impact on the debt trap payday lenders depend on for their revenues. Additional data is available from the states that have tried these reforms, which will provide the basis for a forthcoming CRL state-level analysis.

To solve the problem of high-cost payday lending effectively, state policymakers are increasingly applying their consumer loan laws to all lenders, including Internet lenders.

Most states have an existing interest rate cap in their consumer loan laws in the double digits; about a dozen are set at 36 percent. To prevent predatory payday lending, some states have refused to authorize special exemptions from these limits for payday lenders, whose business model requires them to charge triple-digit interest and repeatedly flip the loans.

Congress recently adopted, and the President signed into law, a 36-percent annual rate cap for consumer loans made to military families, protecting them from predatory payday loans as well as many other high cost loan products. The legislation outlawed taking a security interest in a live check, therefore prohibiting payday lending. The Pentagon reported that payday lenders are targeting their troops, and that servicemen and women are frequently losing security clearance because of their resulting debt problems.[49]

Policymakers interested in preventing predatory payday loan flipping in their states should consider capping annual interest rates on small consumer loans at an all-inclusive 36 percent. This change would continue to allow responsible credit to flow, while saving Americans the billions of dollars now lost to predatory payday lenders.

APPENDIX 1: ANALYSIS OF WASHINGTON STATE DATA[50]

Annual Loan Frequency	Single Shop # of Borrowers	Single-Shop Loans (X)	Loans to Borrowers Using One Lender (53%) A	Loans to Borrowers Using Two Lenders (30%) B	Loans to Borrowers Using Three Lenders (11%) C	Loans to Borrowers Using Four Lenders (6%) D	Multiple Shop Projected Loans (Y)	Multiple Shop Cumulative Loans	Multiple Shop Cumulative Share of Loans	Multiple Shop Projected Number of Borrowers	Multiple Shop Cumulative Borrowers	Multiple Shop Cumulative Share of Borrowers
1	53,730	53,730	28,477				28,477	28,477	1.3%	28,477	28,477	11.1%
2	33,102	66,204	35,088	16,119			51,207	79,684	3.7%	25,604	54,080	21.1%
3	25,094	75,282	39,899	19,861	5,910		65,671	145,355	6.7%	21,890	75,971	29.7%
4	21,023	84,092	44,569	22,585	7,282	3,224	77,660	223,015	10.3%	19,415	95,386	37.2%
5	18,281	91,405	48,445	25,228	8,281	3,972	85,926	308,940	14.3%	17,185	112,571	44.0%
6	15,933	95,598	50,667	27,422	9,250	4,517	91,855	400,796	18.5%	15,309	127,880	49.9%
7	14,165	99,155	52,552	28,679	10,055	5,046	96,332	497,127	23.0%	13,762	141,642	55.3%
8	12,706	101,648	53,873	29,747	10,516	5,484	99,620	596,747	27.6%	12,453	154,094	60.2%
9	11,549	103,941	55,089	30,494	10,907	5,736	102,226	698,973	32.3%	11,358	165,453	64.6%
10	10,463	104,630	55,454	31,182	11,181	5,949	103,767	802,740	37.1%	10,377	175,829	68.7%
11	9,886	108,746	57,635	31,389	11,434	6,099	106,557	909,297	42.0%	9,687	185,516	72.4%
12	11,713	140,556	74,495	32,624	11,509	6,236	124,864	1,034,161	47.8%	10,405	195,922	76.5%
13	7,585	98,605	52,261	42,167	11,962	6,278	112,667	1,146,828	53.0%	8,667	204,588	79.9%
14	6,065	84,910	45,002	29,582	15,461	6,525	96,570	1,243,398	57.5%	6,898	211,486	82.6%
15	5,479	82,185	43,558	25,473	10,847	8,433	88,311	1,331,709	61.5%	5,887	217,374	84.9%
16	4,444	71,104	37,685	24,656	9,340	5,916	77,597	1,409,306	65.1%	4,850	222,223	86.8%
17	4,349	73,933	39,184	21,331	9,040	5,095	74,651	1,483,957	68.6%	4,391	226,615	88.5%
18	3,921	70,578	37,406	22,180	7,821	4,931	72,339	1,556,295	71.9%	4,019	230,633	90.1%
19	3,421	64,999	34,449	21,173	8,133	4,266	68,022	1,624,317	75.1%	3,580	234,214	91.5%
20	3,124	62,480	33,114	19,500	7,764	4,436	64,814	1,689,131	78.1%	3,241	237,454	92.7%
21	2,816	59,136	31,342	18,744	7,150	4,235	61,471	1,750,602	80.9%	2,927	240,381	93.9%
22	2,477	54,494	28,882	17,741	6,873	3,900	57,395	1,807,997	83.6%	2,609	242,990	94.9%
23	2,244	51,612	27,354	16,348	6,505	3,749	53,956	1,861,953	86.1%	2,346	245,336	95.8%
24	2,431	58,344	30,922	15,484	5,994	3,548	55,948	1,917,902	88.6%	2,331	247,667	96.7%
25	1,723	43,075	22,830	17,503	5,677	3,270	49,280	1,967,182	90.9%	1,971	249,639	97.5%
26	2,036	52,936	28,056	12,923	6,418	3,097	50,493	2,017,675	93.3%	1,942	251,581	98.2%
27	764	20,628	10,933	15,881	4,738	3,501	35,053	2,052,727	94.9%	1,298	252,879	98.7%
28	378	10,584	5,610	6,188	5,823	2,585	20,205	2,072,933	95.8%	722	253,600	99.0%
29	312	9,048	4,795	3,175	2,269	3,176	13,416	2,086,348	96.4%	463	254,063	99.2%
30	232	6,960	3,689	2,714	1,164	1,238	8,805	2,095,154	96.8%	294	254,357	99.3%
31	219	6,789	3,598	2,088	995	635	7,316	2,102,470	97.2%	236	254,593	99.4%
32	149	4,768	2,527	2,037	766	543	5,872	2,108,342	97.4%	184	254,776	99.5%
33	167	5,511	2,921	1,430	747	418	5,516	2,113,858	97.7%	167	254,943	99.6%
34	150	5,100	2,703	1,653	524	407	5,288	2,119,146	97.9%	156	255,099	99.6%
35	123	4,305	2,282	1,530	606	286	4,704	2,123,850	98.2%	134	255,233	99.7%
36	94	3,384	1,794	1,292	561	331	3,977	2,127,827	98.3%	110	255,344	99.7%
37	82	3,034	1,608	1,015	474	306	3,403	2,131,229	98.5%	92	255,436	99.7%
38	70	2,660	1,410	910	372	258	2,951	2,134,180	98.6%	78	255,513	99.8%
39	50	1,950	1,034	798	334	203	2,368	2,136,548	98.7%	61	255,574	99.8%
40	51	2,040	1,081	585	293	182	2,141	2,138,689	98.8%	54	255,628	99.8%
41	45	1,845	978	612	215	160	1,964	2,140,653	98.9%	48	255,675	99.8%
42	38	1,596	846	554	224	117	1,741	2,142,394	99.0%	41	255,717	99.9%
43	45	1,935	1,026	479	203	122	1,830	2,144,224	99.1%	43	255,759	99.9%
44	38	1,672	886	581	176	111	1,753	2,145,976	99.2%	40	255,799	99.9%
45	45	2,025	1,073	502	213	96	1,883	2,147,860	99.3%	42	255,841	99.9%
46	38	1,748	926	608	184	116	1,834	2,149,694	99.4%	40	255,881	99.9%
47	22	1,034	548	524	223	100	1,395	2,151,089	99.4%	30	255,911	99.9%
48	24	1,152	611	310	192	122	1,235	2,152,324	99.5%	26	255,936	99.9%
49	28	1,372	727	346	114	105	1,291	2,153,615	99.5%	26	255,963	100.0%
50	21	1,050	557	412	127	62	1,157	2,154,772	99.6%	23	255,986	100.0%
51	159	8,109	4,298	315	151	69	4,833	2,159,605	99.8%	95	256,081	100.0%
	--		--	2,433	116	82	2,631	2,162,235	99.9%			
	--	--	--		892	63	955	2,163,190	100.0%			
						487	487	2,163,677	100.0%			
Total	293,104	2,163,677	1,146,749	649,103	256,081	129,821	2,163,677			256,081		

	Single Shop	Multi Shop
#of loans	2,163,677	2,163,677
#of borrowers	293,104	256,081
Avg loan per borrower	7.381942928	8.449201228

% of loans made to borrowers who receive five or more loans per year	89.7%
% of loans made to borrowers who receive 12 or more loans per year	58%
% of borrowers who receive 5 or more loans per year	62.8%

Since Washington State data does not take into account the fact that payday borrowers frequently go to more than one payday loan shop, we applied the same methodology we used in the 2003 CRL paper to convert single-shop data into multi-shop data.

A 2001 industry-funded study by the Credit Research Center breaks down the percentage of borrowers who use multiple shops.[51] See table below.

Number of stores used	Payday lender customers (%)
1	53
2	30
3	11
4 or more	6
	100

We assume that borrowers take one additional loan from each additional shop they use. Also, we assume that they go to a maximum of only four shops. (In reality, most borrowers take more than one loan from each additional shop and some borrowers go to more than four shops—we have seen borrowers going to 10 shops at a time.)

The table starts with the number of loans attributed to borrowers reported as having received one loan from a single shop (53,730) and then projects multi-shop use as follows:

- 53% of the 53,730 loans attributed to borrowers with one loan need no adjustment = 28,477
- 30% of the 53,730 loans attributed to borrowers with one loan actually went to borrowers who received at least one additional loan (total of two loans) = 16,119
- 11% of the 53,730 loans attributed to borrowers with one loan actually went to borrowers who received at least two additional loans (total of three loans) = 5,910
- 6% of the 53,730 loans attributed to borrowers with one loan actually went to borrowers who received at least three additional loans (total of four loans) = 3,224

It is also helpful to understand this calculation by examining a single row in the column. Turning to row 5 of the table, we can now understand that only 53% of those loans reported as made to borrowers with 5 loans actually reflect the experience of those borrowers (53% * 91,405 = 48,445). However, borrowers in rows two through four of the table also used additional lenders and therefore account for many of the loans we project as made to borrowers with five loans (Column Y = A + B + C + D). We use the survey data to perform the following calculations to project the actual number of borrowers who received five loans accounting for multiple shop use:

- 53% of 91,405 loans attributed to borrowers with five loans from one lender = 48,445.
- 30% of 84,092 loans attributed to borrowers with four loans from one lender (but actually received at least one more from a second lender for a total of five) = 25,228.
- 11% of 75,282 loans attributed to borrowers with three loans from one lender (but actually received at least one more from two additional lenders for a total of five) = 8,281.

- 6% of 66,204 loans attributed to borrowers with two loans from one lender (but actually received at least one more from three additional lenders for a total of five) = 3,972.

- Total of all such borrowers = 85,926 loans to borrowers with five loans total from all lenders.

These calculations do not change the total number of payday loans. The total unadjusted is the same as the total adjusted for multiple shop use – 2,163,677 payday loans to all borrowers. It simply shuffles some of the borrowers to higher loan number categories based on the reported use of multiple shops.

To review, we calculate the number of loans reported to "single shops" (X) by multiplying the number of borrowers (F) from Washington state data by the corresponding number of loans (Q) in equation one. Subsequently, we use this figure as a base for estimating loans resulting from borrowers' use of multiple shops in equation two. Equation two embodies the assumption that borrowers take only one additional loan from each additional lender they reported using.

EQUATION 1: $X_i = F_i * Q_i$

EQUATION 2: $Y_i = 0.53X_i + 0.30X_{(i-1)} + 0.11X_{(i-2)} + 0.06X_{(i-3)}$

APPENDIX 2: PAYDAY COSTS FOR 2005 FOR STATES WITH PAYDAY LENDING

	Payday Stores	Source	Average Loan Amount	Payday Loan Volume Per State	Source	Average Fee*	Source	APR	Total Loan Fees Paid Per State	Multiplier	Predatory Payday Costs Per State
Alabama	1201	(Ferris Baker Watts)	325	1,427,562,919	(CRL estimate)	17.50%	(state limit)	456%	249,823,511	90%	224,841,160
Alaska	21	(regulator data)	364	21,225,918	(regulator data)	19.23%	(regulator data)	501%	4,081,907	90%	3,673,717
Arizona	738	(Ferris Baker Watts)	325	877,220,178	(CRL estimate)	17.65%	(state limit)	460%	154,829,361	90%	139,346,425
Arkansas**	177	(Ferris Baker Watts)	325	210,390,205	(CRL estimate)	10%+$10	(state limit)	340%	27,512,665	90%	24,761,398
California	2445	(regulator data)	253	2,479,725,858	(regulator data)	16.34%	(regulator data)	426%	405,180,411	90%	364,662,370
Colorado	565	(regulator data)	336	494,259,999	(regulator data)	16.99%	(regulator data)	443%	83,974,284	90%	75,576,855
DC	21	(Ferris Baker Watts)	325	24,961,550	(CRL estimate)	10%+$10	(state limit)	340%	3,264,214	90%	2,937,793
Delaware	136	(Ferris Baker Watts)	325	161,655,751	(CRL estimate)	16.00%	(assumed)	417%	25,864,920	90%	23,278,428
Florida	1200	(regulator data)	373	1,630,000,000	(regulator data)	10.77%	(regulator data)	281%	175,547,872	89%	156,237,606
Hawaii	17	(Ferris Baker Watts)	325	20,206,969	(CRL estimate)	17.65%	(state limit)	460%	3,566,530	90%	3,209,877
Idaho	222	(regulator data)	343	169,784,184	(regulator data)	17.00%	(QC Holdings)	443%	28,863,311	90%	25,976,980
Illinois	1357	(Ferris Baker Watts)	325	1,612,991,574	(CRL estimate)	15.10%	(regulator data)	394%	243,561,728	90%	219,205,555
Indiana	585	(regulator data)	246	395,737,752	(regulator data)	14.35%	(regulator data)	373%	56,770,537	90%	51,093,483
Iowa	237	(regulator data)	296	297,108,275	(regulator data)	14.66%	(regulator data)	382%	44,055,039	90%	39,649,535
Kansas	358	(regulator data)	262	225,296,159	(regulator data)	15.00%	(state limit)	391%	33,794,424	90%	30,414,981
Kentucky	695	(regulator data)	325	826,108,433	(CRL estimate)	17.65%	(state limit)	460%	145,808,138	90%	131,227,325
Louisiana	1351	(Ferris Baker Watts)	325	1,605,859,703	(CRL estimate)	$5 + Greater of 20% or $45	(state limit)	560%	345,877,855	90%	311,290,069
Michigan**	741	(Ferris Baker Watts)	325	832,051,659	(CRL estimate)	16.00%	(assumed)	417%	133,128,266	90%	119,815,439
Minnesota	55	(regulator data)	325	65,375,488	(CRL estimate)	6%+$5 for loans $250-$350	(state limit)	196%	4,928,321	90%	4,435,489
Mississippi	572	(Ferris Baker Watts)	325	679,905,070	(CRL estimate)	22.00%	(state limit)	574%	149,579,115	90%	134,621,204
Missouri	1644	(Ferris Baker Watts)	325	1,954,132,755	(CRL estimate)	18.00%	(QC Holdings)	469%	351,743,896	90%	316,569,506
Montana	121	(regulator data)	232	46,222,193	(regulator data)	20.00%	(QC Holdings)	521%	9,244,439	90%	8,319,995
Nebraska	106	(regulator data)	325	125,996,394	(CRL estimate)	17.65%	(state limit)	460%	22,238,364	90%	20,014,527
Nevada	507	(Ferris Baker Watts)	325	602,643,130	(CRL estimate)	20.00%	(QC Holdings)	521%	120,528,626	90%	108,475,763
New Hampshire	51	(Ferris Baker Watts)	366	38,063,060	(regulator data)	16.00%	(assumed)	417%	6,090,090	90%	5,481,081
New Mexico	285	(regulator data)	309	139,582,952	(regulator data)	21.63%	(regulator data)	564%	30,187,242	90%	27,168,518
North Carolina**	385	(CRL estimate)	325	457,628,413	(CRL estimate)	18.00%	(QC Holdings)	469%	82,373,114	90%	74,135,803
North Dakota	72	(regulator data)	261	34,006,663	(regulator data)	19.26%	(regulator data)	502%	6,550,966	90%	5,895,869
Ohio	1375	(Ferris Baker Watts)	325	1,634,387,188	(CRL estimate)	5% +$5/$50	(state limit)	370%	232,588,190	90%	209,329,371
Oklahoma	417	(regulator data)	333	300,700,000	(regulator data)	13.75%	(regulator data)	358%	41,340,719	91%	37,620,054
Oregon	360	(regulator data)	317	278,033,023	(regulator data)	20.26%	(regulator data)	528%	56,325,529	90%	50,692,976
Pennsylvania**	168	(Ferris Baker Watts)	325	199,692,398	(CRL estimate)	16.00%	(assumed)	417%	31,950,784	90%	28,755,705
Rhode Island	17	(Ferris Baker Watts)	325	20,206,969	(CRL estimate)	15.00%	(state limit)	391%	3,031,045	90%	2,727,941
South Carolina	1066	(regulator data)	285	1,170,000,000	(regulator data)	17.65%	(state limit)	460%	206,505,000	90%	185,854,500
South Dakota	302	Ferris Baker Watts)	338	607,509,990	(regulator data)	16.00%	(assumed)	417%	97,201,598	90%	87,481,439
Tennessee	1345	(Ferris Baker Watts)	205	1,008,443,839	(CRL estimate)	$30 or 17.65%, whichever is less	(state limit)	380%	147,577,147	90%	132,819,432
Texas**	1513	(Ferris Baker Watts)	325	1,798,420,230	(CRL estimate)	16.00%	(assumed)	417%	287,747,237	90%	258,972,513
Utah	381	(Ferris Baker Watts)	325	452,873,832	(CRL estimate)	17.00%	(QC Holdings)	443%	76,988,551	90%	69,289,696
Virginia	756	(regulator data)	355	1,197,105,829	(regulator data)	14.81%	(regulator data)	386%	177,291,373	90%	159,562,236
Washington	716	(regulator data)	385	1,382,132,283	(regulator data)	12.47%	(regulator data)	325%	172,317,791	90%	155,086,012
Wisconsin	445	(regulator data)	363	625,261,493	(regulator data)	22.00%	(QC Holdings)	574%	137,557,528	90%	123,801,776
Wyoming	77	(regulator data)	325	57,687,579	(regulator data)	$30 or 20%, whichever is greater	(state limit)	521%	11,537,516	90%	10,383,764
Grand Total	24,803			28,188,157,857					4,628,929,156		4,164,694,169

* Average fees and APRs are calculated based on the amount of the cash advanced, not the amount written on the check, which includes the fee. For example, if a borrower writes a check for $100 and pays 15% of the check amount (15/100), they are actually paying 17.65% of the cash advance of $85 (15/85 =17.65/100).

**With the exception of Texas, these states had rent-a-bank payday lending in 2005. Texas authorizes payday lending, but lenders have begun avoiding state limits by using the Credit Services Organization (CSO) model. This CSO model is another means payday lenders use to avoid state lending laws, in this case, by calling themselves a provider of credit services rather than a lender, and claiming that they are not making loans but rather are brokering them for a third party. Arkansas had rent-a-bank shops last year that are now closing, but also has an unclear future with respect to legal payday loan shops, and still has 177 licensed lenders. (See page 12 for more on the situation in Arkansas.) Michigan has now authorized payday lending. Pennsylvania and North Carolina do not authorize payday lending, and so are also listed in the savings table for 2006. Rent-a-bank payday lending stores in North Carolina and Pennsylvania have closed, so these two states are expected to eliminate the costs of predatory payday lending for their citizens in 2006. The savings projected for North Carolina and Pennsylvania (see Table 5 as well as Appendix 3) are significantly higher than the cost figures included in this table. Cost figures are based on the actual number of payday shops in each state under the rent-a-bank arrangement, a small number of shops relative to the population since payday lending is not authorized in these states. Savings figures are based on the number of shops one would expect in an authorizing state with a mature payday market.

METHODOLOGY AND SOURCES

To quantify the cost of predatory payday lending for each state, we multiplied total payday loan fees per state by 90 percent, which is our estimate of the percentage of payday loans that go to borrowers caught in a cycle of abusive lending, except in Florida and Oklahoma. For Florida we used 89 percent and for Oklahoma we used 91 percent instead. (See page 6.)

Payday Loan Volume Per State

State regulator data calculating total loan volume was available for 20 of the 42 states (including the District of Columbia) where payday loans were made in 2005. These states include:

Alaska, California, Colorado, Florida, Idaho, Indiana, Iowa, Kansas, Montana, New Hampshire, New Mexico, North Dakota, Oklahoma, Oregon, South Carolina, South Dakota, Virginia, Washington, Wisconsin, Wyoming

For those remaining 22 states where data is not collected or is not publicly available, loan volume was estimated based on the following equation.

Loan Volume = # of Payday Stores * Average Loan Amount * # of Transactions Per Store

Number of Payday Stores

We used the total number of payday loan storefronts reported by state regulator in states where this data was available for 2005. For the remaining states, with the exception of North Carolina, we used the number of payday stores from investment banker Ferris, Baker, Watts Inc. For North Carolina, we used our dataset from a previous CRL publication, "Race Matters: The Concentration of Payday Lenders in African-American Neighborhoods in North Carolina."[52]

Average Loan Amount

Regulators in 19 states either directly reported average loan size or had data for which average loan size could be calculated for 2005. In addition, Tennessee's latest available regulator data from 2004 reported an average loan size of $205. Tennessee only allows payday lenders to charge a maximum fee of $30, which causes most loans to be around $200 or less—a far lower rate than other states. Because of this, Tennessee's 2005 average loan size is not likely to be significantly different than the average loan size in 2004.

The median loan amount among these 20 states, $325, is assumed to be the average loan amount in the remaining states where regulator data was not available.

State	Average Loan Amount
Alaska	$364
California	$253
Colorado	$336
Florida	$373
Idaho	$343
Indiana	$246
Iowa	$296
Kansas	$262
Montana	$232
New Hampshire	$366
New Mexico	$309
North Dakota	$261
Oklahoma	$333
Oregon	$317
South Carolina	$285
South Dakota	$338
Tennessee	$205
Virginia	$355
Washington	$385
Wisconsin	$363
Median	$325

Number of Transactions Per Store

Based on data in 18 states where the number of transactions per store can be calculated, we calculated an average number of payday transactions per shop of 3,657 transactions per year. This national estimate of the typical payday store's lending activity was calculated by taking a weighted average of each of the 18 states' data, to normalize for varying numbers of payday stores across states.

State	# of loans	# of stores	# of loans per store
Alaska	58,312	21	2,777
California	9,785,004	2,445	4,002
Colorado	1,472,470	565	2,606
Florida	4,300,000	1,200	3,583
Idaho	494,736	222	2,229
Indiana	1,609,164	585	2,751
Iowa	1,002,406	237	4,230
Kansas	859,832	358	2,402
Montana	199,569	121	1,649
New Hampshire	104,000	51	2,039
North Dakota	131,736	72	1,830
Oklahoma	903,130	417	2,166
Oregon	840,748	360	2,335
South Carolina	4,100,000	1,066	3,846
South Dakota	1,799,941	302	5,960
Virginia	3,372,103	756	4,460
Washington	3,593,873	716	5,019
Wisconsin	1,724,135	445	3,874
Total	36,351,159	9,939	
Weighted Average			3,657

Confidence Interval	Lower Bound	3,639
(95%)	Upper Bound	3,676

It should be noted that the estimate of 3,657 transactions per store is conservative in comparison to the estimates of two industry sources. Figures from a 2006 report by Stephens Inc. can be used to estimate 4,347 loans per store annually, and Advance America, the largest payday lender in America, provides figures in its latest 10-K filing with the SEC that suggest 4,672 transactions per store each year.

However, after analyzing the payday store data available, it is clear that these industry estimates do not fall within our 95% confidence interval (3,639 – 3,676). Therefore, we reject these estimates as acceptable proxies for estimating volume in states without specific data, and instead use our more conservative figure.

Industry-Wide Estimate from Stephens Inc.:

	2005	Source/Calculation
# of Transactions	Over 100,000,000	Stephens Inc March 2006
# of Stores	23,000	Stephens Inc March 2006
# of Transactions per Store	4,347	# of Transactions/# of stores

Advance America Estimate:

	2005	Source/Calculation
# of Transactions	11,620,000	Advance America 10K 2005
# of Stores	2,487	Advance America 10K 2005
# of Transactions per Store	4,672	# of transactions/# of stores

Typical Cost Per Payday Loan

We have used several sources to estimate the typical fee in each state. These sources are:

- Fees charged as reported by state regulators;
- QC Holdings' reported fee percentage for various states, from its SEC filings;
- Each state's rate cap (variable interest and fixed fee);
- For states that do not have rate caps or any other source of information, we used 16 percent, based on Advance America's average, a conservative assumption considering it's very likely that those states without payday rate caps would have higher costs than the national average.

Total Payday Loan Interest/Fees Paid Per State

a) In most cases the typical fee is a variable interest rate, and there is no fixed fee associated with the loan. In that case, the calculation for Total Payday Loan Interest/Fees Paid Per State is:

Total Payday Loan Interest/Fees Paid Per State = Total State Loan Volume * Interest %

b) In other cases there is a fixed fee in addition to the variable interest. For example, in DC the state rate cap is 10%, with a $10 fee for each transaction. In these cases we use the formula below to calculate Total Payday Loan Interest and Fees Paid Per State:

$$\text{Total State Loan Volume} * \text{Interest \%} + \left[\frac{\text{Total State Loan Volume}}{\text{Avg. loan amount in the state}} * \text{fixed fee} \right]$$

Percentage of predatory loans

We define predatory loans as those made to borrowers who had five or more loan transactions per year.

Our analysis of the Washington State data in Appendix 1 shows that 90 percent of payday loans are predatory, almost identical to the percentage we calculated for our 2003 report, which was based on North Carolina data. Washington's data is more recent than the North Carolina data used in CRL's 2003 report and is one of the few states that provide a detailed breakdown of the number of loans per borrower in a year. From this data, we can estimate the percentage of loans that were made to borrowers who had five or more loan transactions per year. We use the Washington State percentage for all states except Florida and Oklahoma. Florida has a slightly lower multiplier possibly due to its limit of one payday loan per borrower at a time, and Oklahoma has a slightly higher number multiplier of 91% based on findings from its state regulator database.

APPENDIX 3: PROJECTED SAVINGS FOR 2006 IN STATES THAT HAVE ENFORCED BANS ON PAYDAY LENDING

Non-Authorization States	2000 Population	Households	Projected Payday Stores	Projected Total State Loan Volume	Fee %	Projected Payday Loan Fees	Projected Predatory Payday Costs per State
			HHs/3500*	(payday stores * 1,188,525)		(Total State Loan Volume * Fee %)	(Payday Loan Fees * Multiplier)
Connecticut	3,405,565	1,301,670	372	442,019,239	16%	70,723,078	63,650,770
Georgia	8,186,453	3,006,369	859	1,020,898,490	16%	163,343,758	147,009,383
Maine	1,274,923	518,200	148	175,969,616	16%	28,155,139	25,339,625
Maryland	5,296,486	1,980,859	566	672,657,269	16%	107,625,163	96,862,647
Massachusetts	6,349,097	2,443,580	698	829,787,406	16%	132,765,985	119,489,386
New Jersey	8,414,350	3,064,645	876	1,040,687,771	16%	166,510,043	149,859,039
New York	18,976,457	7,056,860	2,016	2,396,358,438	16%	383,417,350	345,075,615
North Carolina	8,049,313	3,132,013	895	1,063,564,500	16%	170,170,320	153,153,288
Pennsylvania	12,281,054	4,777,003	1,365	1,622,167,854	16%	259,546,857	233,592,171
Vermont	608,827	240,634	69	81,714,150	16%	13,074,264	11,766,838
West Virginia	1,808,344	736,481	210	250,093,166	16%	40,014,907	36,013,416
Totals	74,650,869	28,258,314	8,074	$9,595,917,899		$1,535,346,864	$1,381,812,177

SOURCES: U.S. Census Bureau: 2000 Census, American Community Survey 2003; Morgan Stanley's assumption of 3500 households per branch as a saturation point. Advance America report Jan 25, 2005, pg 25

To estimate the savings in states that have enforced bans against payday lending, we first must predict the number of stores that would open after the legalization of payday lending in a state.

Using Morgan Stanley's assumption of 3,500 households per payday loan store for average state saturation, we divide household figures in each state by 3,500.[53] For example, Connecticut has 1,301,670 households, so we predict that after authorization it would have 372 stores. For all non-authorization states combined, we project 8,074 new stores.

We calculated the potential loan volume in each state by multiplying our estimate of the number of stores by annual loan originations per store and median loan size (See Appendix 2). Connecticut's 372 stores would generate $442 million with all non-authorization states generating $9.6 billion in loan volume annually. Next, we multiplied the loan volume in each state by a typical rate cap, based on Advance America's average fee of 16 percent, to get total projected payday loan fees. We then took 90 percent of that figure, which is our estimate of the cost of payday loans that would go to borrowers caught in a cycle of abusive lending.

Consistent with our overall methodology, we have used conservative assumptions about saturation levels in order to provide a reliable lower-end estimate. In North Carolina, for example, there were an estimated 1000 payday shops when payday lending was legal in the state between 1997 and 2001. Using Morgan Stanley's assumption of 3,500 households per payday loan store for average state saturation, we estimate 895 North Carolina shops in a mature market. These more conservative payday shop counts lower our projected savings figure.

A less conservative methodology of calculating payday lending growth in non-authorization states would be to use the assumptions of Stephens Inc., which used the payday lending concentration in the state of Tennessee as the proxy for a mature market, consequently predicting steady growth for the national market.[54] In the report, Tennessee is listed as having 1,200 payday loan shops, equating to roughly one store for every 1,900 households.[55] This would probably be an aggressive figure to use nationwide; it would assume that all states can bear the saturation of Tennessee, which according to the May 24, 2004 Stephens Inc. report is the second most payday-saturated state in the country behind only Mississippi.[56]

NOTES

1 These short-term loans are also referred to as deferred deposit, deferred presentment, or check loans.

2 Based on 2003 data placing the general cost of payday loans between a $15 and $17 fee per $100 loaned for a period of approximately 14 days, amounts equivalent to annual percentage rates of 391% and 443% respectively. See *Update on the Payday Loan Industry: Observations on Recent Industry Developments*, Stephens Inc. (September 26, 2003).

3 The investment bank, Stephens Inc., estimates the annual loan volume of the industry at $40 billion for 2005. CRL has relied upon Stephens Inc. for broad, national estimates in the past. However, considering the new data accessible from state regulators and other sources, the authors have opted to use more precise regulator data where available for this paper.

4 Estimates of the annual loan volume of the industry in 2000 range from $8 to $14 billion. See Michael Stegman and Robert Faris, *Payday Lending: A Business Model That Encourages Chronic Borrowing*, Economic Development Quarterly, Vol. 17, No. 1 (February 2003).

5 Thirty-six states (AL, AK, AZ, CA, CO, DE, FL, HI, ID, IL, IN, IA, KS, KY, LA, MI, MN, MS, MO, MT, NE, NV, NH, ND, OH, OK, OR, RI, SC, SD, TN, TX, UT, VA, WA, WY) have laws or regulations that specifically permit payday loans. Updated from Jean Ann Fox, *Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury*, Consumer Federation of America, March 2004.

6 See *Stegman*, endnote 4 at p8. See also John P. Caskey, *The Economics of Payday Lending*, Center for Credit Union Research, 2002; and Peter Skillern, *Small Loans, Big Bucks: An Analysis of the Payday Lending Industry in North Carolina*, Community Reinvestment Association of North Carolina, 2002.

7 Keith Ernst, John Farris & Uriah King, *Quantifying the Economic Cost of Predatory Payday Lending*, Center for Responsible Lending (2003), available at http://www.responsiblelending.org/pdfs/CRLpaydaylendingstudy121803.pdf.

8 Advance America, the largest payday lender in the nation, reported an average loan principal of $339 in their 2005 annual report to the U.S. Securities and Exchange Commission. Advance America, Cash Advance Centers, Inc., *2005 Annual Report*, p5 (2006).

9 Consistent with *Stegman* (see endnote 4), FDIC researchers recently found no reason to distinguish between rollovers and back-to-back transactions. Flannery & Samolyk, *Payday Lending: Do the Costs Justify The Price?*, 2005, http://www.fdic.gov/bank/analytical/cfr/cfr_wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf at footnote 10.

10 For example, Sandra Harris turned to payday lending in a tough time. After several rollovers, Sandra's first loan was due in full. She couldn't pay it off, so she took a loan from a second lender. Frantically trying to manage her bills, Sandra eventually found herself with six simultaneous payday loans. She was paying over $600 per month in rollover fees, none of which was applied to pay down her principal. Sandra was evicted and her car was repossessed. Story available at www.responsiblelending.org.

11 See *Fox*, endnote 5 at p8.

12 For example, North Carolina experimented with exempting payday loans from their consumer loan interest rate cap of 36 percent for four years, from 1997 to 2001, during which payday lenders commonly charged interest rates in the 400-percent range. See *Stegman*, endnote 4 at p2.

13 For example, in one form of subterfuge the lender offers a rebate for signing up for Internet service. The rebate is actually a payday loan, and the borrower is interested in this loan rather than Internet access. The borrower typically authorizes the lender to draw from their checking account for a monthly or biweekly fee that renews the contract. They must pay back the "rebate" and the fee to cancel and get out of the contract for good. See *AG Cooper Shuts Down Phony Rebate Payday Loan Scheme*, North Carolina Attorney General press release (June 8, 2004) at http://www.ncdoj.com/DocumentStreamerClient?directory=PressReleases/&file=American%20funding.pdf.

14 See *Fox*, endnote 5 at p11.

15 Over the past four years in North Carolina, prior to action by the Attorney General, payday lenders in North Carolina have partnered with several out-of-state banks to make loans in North Carolina. The payday lending chains include, among others, Advance America, Check Into Cash, Check 'N Go, First American Cash Advance (CompuCredit), and QC Holdings (dba Nationwide Budget Finance). Partner banks have included County Bank of Rehoboth Beach, DE, Republic Bank & Trust, KY, American Bank & Trust, SD, Community State Bank, SD, and First Fidelity Bank, SD.

16 Federal Deposit Insurance Corporation, *Payday Lending Programs Revised Examination Guidance*, (March 1, 2005), available at http://www.fdic.gov/news/news/financial/2005/fil1405.html.

17 324 F.Supp.2d 1333 (N.D. Ga. 2004), aff'd, 411 F.3d 1289 (11th Cir. 2005), vacated for rehearing en banc, 433 F.3d 1344 (11th Cir. (en banc) 2005), order granting rehearing en banc vacated for remand to panel for consideration of mootness, 2006 WL 1329700 (11th Cir. (en banc) April 27, 2006), prior decisions vacated as moot, 446 F.3d 1358 (11th Cir. 2006).

18 Order of the Commissioner of Banks of North Carolina, December 22, 2005 available at http://www.nccob.org/NR/rdonlyres/AF33D27C-2D74-40D5-88BE-E701B031DDB4/0/43_AANCFINALORDER122205.pdf. *Payday lending on the way out in NC*, NC Attorney General press release, March 1, 2006, available at www.ncdoj.com/DocumentStreamlinerclient?directory=PressRelease*file=paydaylenders3.06pdf.

19 For example, William Webster, IV, co-founder of Advance America, was among the top ten contributing lobbyists in the 2003-2004 election cycle in North Carolina, according to a report by Democracy North Carolina. See *Lobbyists donated $450,000 to state legislators but their fund-raising goes undisclosed*, July 17, 2006, available at http://www.democracy-nc.org/moneyresearch/2006/lobbyistdonations.html.

20 Illinois has implemented a database, but relevant data has not yet been released.

21 Data is based on voluntary reporting by 63% of the industry. See *Payday Lending Report Statistics & Trends* 2005,Washington State Department of Financial Institutions, 2005 data, available at http://www.dfi.wa.gov/cs/pdf/2005_payday_report.pdf.

22 *Florida Trends in Deferred Presentment*, State of Florida Department of Banking and Finance, Oct 04- Sep 05 data; http://www.veritecs.com/FL_trends_sep_2005.pdf.

23 *Oklahoma Trends in Deferred Deposit Lending*, Veritec Solutions for the Oklahoma Department of Consumer Credit, September 2005: http://www.veritecs.com/OK_trends_11_2005.pdf.

24 Paul Chessin, *Borrowing From Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act*, Denver University Law Review, (2005) at p409.

25 Oklahoma and Florida require lenders to record each transaction in a central database supervised by the state. Veritec Solutions began implementing a central database for Florida in 2001 and for Oklahoma in 2003.

26 See *Ernst*, endnote 5 at p13.

27 *2005 Annual Report*, Operation of Deferred Deposit Originators, California Dept. of Corporations, http://www.corp.ca.gov/pdf/CDDTL2005ARC.pdf.

28 *Iowa Division of Banking survey results for 2005*, Rod Reed, Finance Bureau Chief. The survey was conducted at 109 delayed deposit services branches, and at each branch the examiner reviewed a 12-month history of the last 20 borrowers. See Sheila Bair, *Low-Cost Payday Loans: Opportunities and Obstacles*, Isenberg School of Management, University of Massachusetts, June 2005, p8. Available at http://www.aecf.org/publications/data/payday_loans.pdf.

29 *Payday Lender Licensees Check Cashers Operating at the Close of Business December 31, 2005*, Virginia: Bureau of Financial Institutions, State Corporation Commission, Virginia, 2005 data; http://www.scc.virginia.gov/division/banking/forms/ar04-05.pdf.

30 Advance America, Cash Advance Centers, Inc., *2005 Annual Report*, p5 (2006); QC Holdings, Inc. 2005 Annual Report, p4, (2006), available at http://www.sec.gov.

31 Survey on file with Sheila Bair, see endnote 28 at p79.

32 "...the data are consistent with the charge that most payday loan customers are frequent borrowers who may be trapped in a persistent and costly debt cycle." See *Caskey*, endnote 6 at p38; and "...the financial performance of the payday loan industry, at least in NC, is significantly enhanced by the successful conversion of more and more occasional users into chronic borrowers." See *Stegman*, endnote 4 at p1.

33 Morgan Stanley Report, *Advance America: Initiating with an Underweight-V Rating*, January 25, 2005 at p10.

34 *The Cost of Providing Payday Loans in Canada*, Ernst & Young, p46, Oct 2004.

35 Flannery & Samolyk, *Payday Lending: Do the Costs Justify The Price?*, June 2005. http://www.fdic.gov/bank/analytical/cfr/cfr_wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf.

36 Though the FDIC researchers note that repeat borrowers do not affect store profits beyond their proportional contribution to total loan volume, this is a distinction without a difference. The salient point, confirmed in their findings, is that a high number of borrowers take out multiple loans per year, accounting for nearly all of payday lenders' revenues.

37 See *Flannery*, endnote 34 at p2.

38 "Where there is any 'competition' in finance charge pricing, it occurs primarily in what can be characterized as 'promotional' loans. For example, some lenders offer discounts to consumers for the consumer's very first loan; others will discount, for example, every tenth loan." See Chessin, endnote 24 at p409.

39 See *Flannery*, endnote 34 at p9.

40 See *Chessin*, endnote 37 at p409.

41 Morgan Stanley has observed that Mississippi, New Mexico and Tennessee appear to be saturated with payday lenders. See *Morgan Stanley Advance America Equity Research Report*, p25, (Jan. 25, 2005). Stephens, Inc. recently used the payday lending concentration in the state of Tennessee as the proxy for a mature market. In the report, Tennessee is listed as having 1,200 payday loan shops, equating to roughly one store for every 5,000 people. See Dennis Telzrow & David Burtzlaff, *Industry Report: Payday Loan Industry*, 4 Stephens, Inc., (May 24, 2004).

42 See Advance America, 2005 *Annual Report*, endnote 29 at p5 (2006).

43 QC Holdings, Inc., 2005 *Annual Report*, at p8 (2006), available at http://www.sec.gov.

44 See *Ernst*, endnote 7 at p8.

45 See Peter Skillern, *Small Loans, Big Bucks: An Analysis of the Payday Lending Industry in North Carolina*, (2002) (comparing payday loans to returns on equity from credit cards); see also, Jean Ann Fox and E. Mierzwinski, *Rent-A-Bank Payday Lending: How Banks Help Payday Lenders Evade Consumer Protections*, (November 2001) at endnote 16 (detailing additional rate-risk comparisons with other types of financial products).

46 See endnote 13.

47 *Payday Lenders in Arkansas: The Regulated and the Unregulated: An Updated Study*, Arkansans Against Abusive Payday Lending, February 2006. Available at www.stoppaydaypredators.org/pdfs/news%20articles/06_0200_Payday_U_Study.pdf.

48 On Nov. 16, 2006, the Arkansas Supreme Court sent the question of whether payday lending violates the state's constitution back to a circuit court, leaving the businesses still open until it is decided. See David Smith, "Once again, payday loans escape ruling," *Arkansas Democrat-Gazette*, Nov. 17, 2006 at p1.

49 Department of Defense, *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*, Aug. 9, 2006. Available at http://www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf.

50 See Washington State Department of Financial Institutions report, endnote 21.

51 G. Elliehausen & E.C. Lawrence, *Payday Advance Credit in America: An Analysis of Consumer Demand*, (Monograph. 35), Georgetown University, McDonough School of Business, Credit Research Center (2001) at p49.

52 Uriah King, Wei Li, Delvin Davis and Keith Ernst, *Race Matters: The Concentration of Payday Lenders in African-American Neighborhoods in North Carolina*, March 22, 2005, at p8. Available at http://www.responsiblelending.org/reports/NCDispImpact.cfm. For this paper, we surveyed payday lending stores operating in NC by submitting the company names to a telephone database.

53 See Morgan Stanley, endnote 40 at p25.

54 See Stephens Inc, endnote 40 at p4.

55 Tennessee has a total of 2,295,640 households per the U.S. Census Bureau, *American Community Survey*, 2003 available at http://www.census.gov/acs/www/Products/Profiles/Single/2003/ACS/Tabular/040/04000US471.htm.

56 See Stephens Inc., endnote 40 at p5-6.

About the Center for Responsible Lending

The Center for Responsible Lending is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is affiliated with Self-Help, one of the nation's largest community development financial institutions.

Visit our website at **www.responsiblelending.org.**

North Carolina
302 West Main Street
Durham, NC 27701
Ph (919) 313-8500
Fax (919) 313-8595

California
1330 Broadway
Suite 604
Oakland, CA 94612
Ph (510) 379-5500
Fax (510) 893-9300

District of Columbia
910 17th Street NW
Suite 500
Washington, DC 20006
Ph (202) 349-1850
Fax (202) 289-9009

© Copyright 2006