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Predatory Payday Lending Reform

Alexander Bartik, Lulu Cheng, Brandon Fong, Gregory Geusic, Benjamin Lazarus,
& Jacob Koch; Yale University

By structuring laws to close readily exploited loopholes, states can effectively prevent the predatory payday lending practices that exploit the desperation of America's workers.

Payday lending undermines the economic security of working individuals and families. Many low-income workers, lacking the credit history and collateral needed to obtain a traditional loan but still in need of quick cash, turn to payday lenders who require only a bank account.

The borrower gives a postdated personal check to the lender in return for cash. In most cases, however, borrowers are unable to fully repay their debt, and they consequently incur repeated bounced check fees. The rolled-over long-term loans have annual percentage rates (APRs) of interest ranging from 391 to 443 percent on average. These exorbitant fees and APRs trap needy consumers in endless cycles of debt. Because borrowers are unable to pay off an initial loan, 91 percent of all loans go to borrowers with at least 5 payday loans per year. As a result, the typical borrower ends up paying a total of \$793 in order to fully pay off a loan of \$325.

KEY FACTS

- Payday lending has grown into a \$28 billion dollar industry, nearly tripling in size over the past six years.
- The average payday loan rollover has an APR ranging from 391 to 443 percent.
- The typical borrower pays \$793 in fees and payments in order to fully pay off the loan.

HISTORY

The predatory payday loan industry has undergone a massive expansion over the past few years. A \$10 billion national industry in 2000, payday lending grew to a \$28 billion industry by 2006. In 2006, the 109th Congress recognized the serious threat predatory payday lending practices pose to the economic security of working Americans, passing the Talent-Nelson Amendment to cap APR rates on all short-term loans to military personnel at 36 percent.

TALKING POINTS

- Predatory payday lending exploits needy consumers and traps them in an endless cycle of debt.
- Payday lenders readily exploit legal loopholes to avoid regulation in most states.
- The U.S. Congress prohibited predatory payday loans to military personnel in 2006. All other citizens remain at risk.

Many states have attempted to regulate lending practices, though to date, only a handful have managed to close the loopholes readily exploited by predatory lenders.

ANALYSIS

By comparing the laws of states that have successfully prohibited predatory payday lending with those that have not, we can understand how to close loopholes and prohibit these exploitative practices across the country. Illinois



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legislation passed in 2001 and 2005 has overwhelmingly failed to prevent predatory practices because the laws target specific loan lengths. For example, when lenders were prohibited from charging high interest rates on loans shorter than 30 days, they immediately began offering 31-day loans with the same high APRs.

Connecticut, on the other hand, uses a broad usury law, capping all small loan APRs at a more reasonable rate. This has effectively prevented predatory payday lending in the state. Around the country, the market for predatory payday loans is driven by a lack of knowledge about alternatives and consequences, so credit counseling and education services should accompany any usury regulations.

AUDIENCE

Predatory payday lending regulation can be implemented on the state or national level. Each state has its own banking and usury laws, and successful regulation generally expands these laws to better regulate payday lenders. National legislation would also be effective. Education and credit counseling services can be developed on any level, though the responsibility for implementation will ultimately rest with local communities.

NEXT STEPS

States should act to implement legislation preventing predatory payday lending practices. Laws must be broad, placing APR caps on all small loans, and applying to all citizens. This way, lenders will be unable to continue modifying loan terms to avoid regulation. State regulations on short-term loans should include several stipulations. A “cooling-off period,” when borrowers are limited to one loan at a time and must wait 15 days between paying off one loan and taking out another, along with a cap limiting loan rollovers to two, will help prevent consumers from getting trapped in an endless cycle of debt.

Alternatives to payday loans do exist, and borrowers should be informed of these alternatives. Credit unions, social service programs, charities and faith-based organizations throughout the country offer assistance to individuals in financial need, both in the form of loans and free credit counseling. All states also have winter heating cost assistance programs aimed at eliminating a major cause of payday loan demand. Public education campaigns should be established to inform individuals that payday loans are not the only option for fast cash.

SOURCES

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