THE PEW CHARITABLE TRUSTS

Payday and Small-Dollar, High-Cost Installment Loans

NCSL – August 4, 2015 – Seattle, WA
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Pew Resources for Understanding the CFPB's Proposal

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- Most comprehensive resource for research on payday, auto title, etc.
- New Animation – How to Fix Payday Loans:

- New Issue Brief:


A brief from THE PEW CHARITABLE TRUSTS | July 2015

Understanding the CFPB Proposal for Payday and Other Small Loans

- New Public Opinion Survey:


CFPB Proposal for Payday and Other Small Loans

CFPB Proposal: Summary

	Short-term loans Loan duration of 45 days or less	Longer-term loans Loan duration of more than 45 days; All-in APR of more than 36%; Preferred repayment position*	
Ability to repay (ATR)	**(1) Short-term ATR** Lender must assess borrower's finances to ensure ability to repay: • Verify income • Verify major financial obligations • Check borrowing history[†] • Make a reasonable determination that sufficient income remains to cover loan costs and estimated living expenses	**(3) Longer-term ATR** Lender must assess borrower's finances to ensure ability to repay: • Analysis is similar to short-term ATR loan • If borrower shows signs of distress, refinancing restrictions apply • Does not limit loan size, payment size, cost, duration, or how long a lender may hold access to a deposit account or car title	
Alternative requirements	**(2) Short-term alternative** • $500 maximum loan amount • Mandatory 60 days without borrowing after three consecutive loans • 90-day maximum indebtedness per 12-month period • Taper to zero loan balance after several consecutive loans • No holding of car titles	**(4) Longer-term alternative: NCUA-type loans[‡]** • 28% interest + $20 fee • Loan amounts of $200 to $1,000 • Six-month maximum loan duration • Maximum of two loans per six-month period	**(5) Longer-term alternative: 5% payment-to-income ratio[§]** • Monthly payment cannot exceed 5% of gross monthly income • Six-month maximum loan duration • Maximum of two loans per 12-month period

Understanding the CFPB's Proposal

- CFPB rule will set a floor for all states
  - Pros: Minimum standards for underwriting, monthly payment size…
  - Cons: Little or no guidance on pricing, loan duration… → risks remain
  - *High-cost credit will remain widely available in many states*
- The scope of the CFPB framework is limited
  - Short-term loans (up to 45 days)
  - Longer-term loans (longer than 45 days) **only IF**:
    high-cost (greater than 36% "all-in" APR); **and**
    "Preferred repayment position" (access to checking account, car title)

Understanding the CFPB’s Proposal

- Impact on states will vary
  - Some states don’t allow high-cost lending today. They won’t need to change.
  - Some states that currently allow **high-cost installment lending** will find that payday lenders continue to expand into that area → **many risks, which the CFPB proposal would not fully control**

Going forward, states that have high-cost installment lending will have to control for serious risks – even with a strong CFPB rule in place.

(States without high-cost installment lending will not have this challenge)

Risks: High-Cost Installment Lending

Pew's Policy Recommendations	Provision	Risks	**CFPB Compliant High-Cost Installment Loans** (3/26/15 CFPB Proposal)

Risks: High-Cost Installment Lending

Pew's Policy Recommendations	Provision	Risks	CFPB Compliant High-Cost Installment Loans (3/26/15 CFPB Proposal)
1. Limit payments to an affordable share of borrower's income	**Monthly payments**	Most borrowers can't afford monthly payments larger than 5% of their monthly pretax paycheck. Typical payday loans today take 36%.	**Medium Risk?**
2. Spread costs evenly over the life of the loan	**Refinancing / Re-borrowing**	"Loan flipping" risk occurs where month 1 is worth more revenue than other months, so up-front fees should be strongly contained.	**High Risk**
	Amortization	Non-standard amortization or very long loan durations punish borrowers in non-transparent ways.	
	Prepayment	Most borrowers repay high-cost payday installment loans early if they can; they should not be charged prepayment fees or otherwise discouraged.	

Risks: High-Cost Installment Lending

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3. Guard against harmful collection practices	**Preferred Repayment Position**	Holding access to the borrower's checking account or car title gives the lender unusually strong leverage, so it should not last indefinitely.	**Medium to High Risk**
	Default/NSF fees	Large fees that can be triggered repeatedly can drive up costs and lead to consumer loss of checking account.	
	Acceleration	Aggressive acceleration clauses can unfairly punish borrowers by forcing large lump-sum payments even for minor violations of agreement.	
4. Require concise disclosures	**Disclosure**	Need fair disclosure of periodic and total costs.	Varies

Risks: High-Cost Installment Lending

Pew's Policy Recommendations	Provision	Risks	**CFPB Compliant High-Cost Installment Loans** (3/26/15 CFPB Proposal)
5. Set maximum allowable charges	**Cost**	This market lacks price competition: Deep subprime borrowers are not price sensitive (focus on speed, access instead). Lenders charge far more for the same loan than they do in other states that have more reasonable pricing policies. See "How State Rate Limits Affect Payday Loan Prices" (Pew, 2014).	**High Risk**
Other pertinent provisions	**Duration**	For a $500 loan, a duration of about 6 months is reasonable. If it lasts longer, problems arise (excessive cost, abusive amortization schedules, etc.).	**High Risk**
	Loan size	The larger the loan size, the less policy justification there is for allowing high costs, preferred repayment positions, streamlined underwriting rules, and so on.	**Medium Risk**

A Market Lacking Price Competition

How much does a $500 payday loan cost for 2 weeks?

	Advance America	ACE Cash Express	Check Into Cash	Check 'n Go
Colorado	$22	$22	$22	---
Florida	$55	$55	$53	$55
Michigan	$65.45	---	$65.45	$65.45
Kansas	$75	$75	$75	$75
Alabama	$87.50	$87.50	$87.50	$87.50
Texas	$102	$127	$102	$127

Costs listed on company websites as of March 31, 2015

The prices charged reflect fee limits in all states except Texas, which has no limit.
See: "How State Rate Limits Affect Payday Loan Prices" (Pew 2014)

A Tighter CFPB Rule Could Help Mitigate These Risks

Make dangerous loans safer

- **Limit loan duration or limit how long lenders may hold a preferred repayment position.**
  Protect against unreasonable loan durations; constrain lenders' unique and potentially harmful power to collect payment before other bills are paid by accessing borrowers' bank accounts or repossessing their vehicles.
- **Eliminate the short-term alternative loan, or, if it is kept, significantly increase requirements for offering it.**
  Protect against deceptive or unaffordable loan structures.
- **Require all fees to be pro rata refundable for loans that are refinanced or repaid early.**
  Mitigate the risk of loan flipping and the resulting harm.

Make safe loans easier to provide

Colorado's 2010 payday loan reform shows that better outcomes are possible compared to conventional payday loans, but only with affordable installment payments and several other critical safeguards in place.

Case Study: CO Payday Installment Loan

2010: Colorado payday loan reform

Eliminated the conventional, 2-week payday loan.

Replaced it with a 6-month installment loan (**max $500**) featuring:

1. Affordable payments
   – Average borrower pays 4% of paycheck, not one-third+
2. Fully amortizing loan with equal installment payments
   – Origination fee pro-rata refundable (*critical* – avoids loan flipping)
   – No prepayment penalties
3. Reduced (but still high) cost: Avg. APR 115% w/ interest and fees

Outcomes:
CO Payday Installment Loan Reform

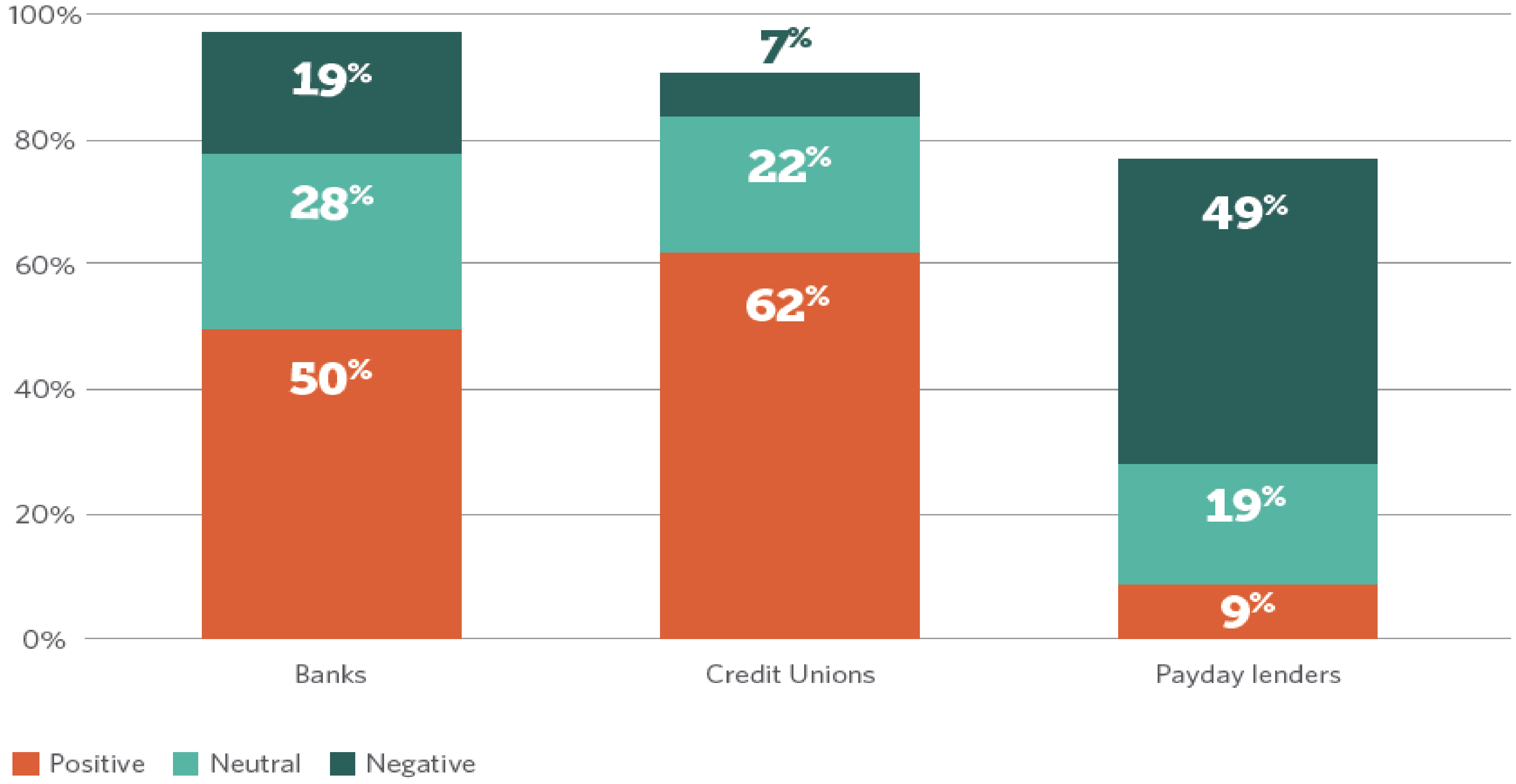
In 2010, Colorado required payday loans to become installment loans (max $500) w/ more affordable payments and several critical safeguards:

1. Maintained access to credit
2. Kept lenders in business (fewer stores serving more people each)
3. Payments more affordable (4% of paycheck now vs. 38% before)
4. Total spent by borrowers on fees declined 42%
5. Lender-charged bounced check fees declined 48%
6. Defaults per year have declined 23%
7. Less oversight required to ensure consumer safety, because reform was structural: loans are safer and more affordable
8. Credit counselors and elected officials report fewer people coming to them with payday loan problems

There is overwhelming support for payday loan reform, both among the general public and borrowers.

Only 1 in 10 Americans View Payday Lenders Positively

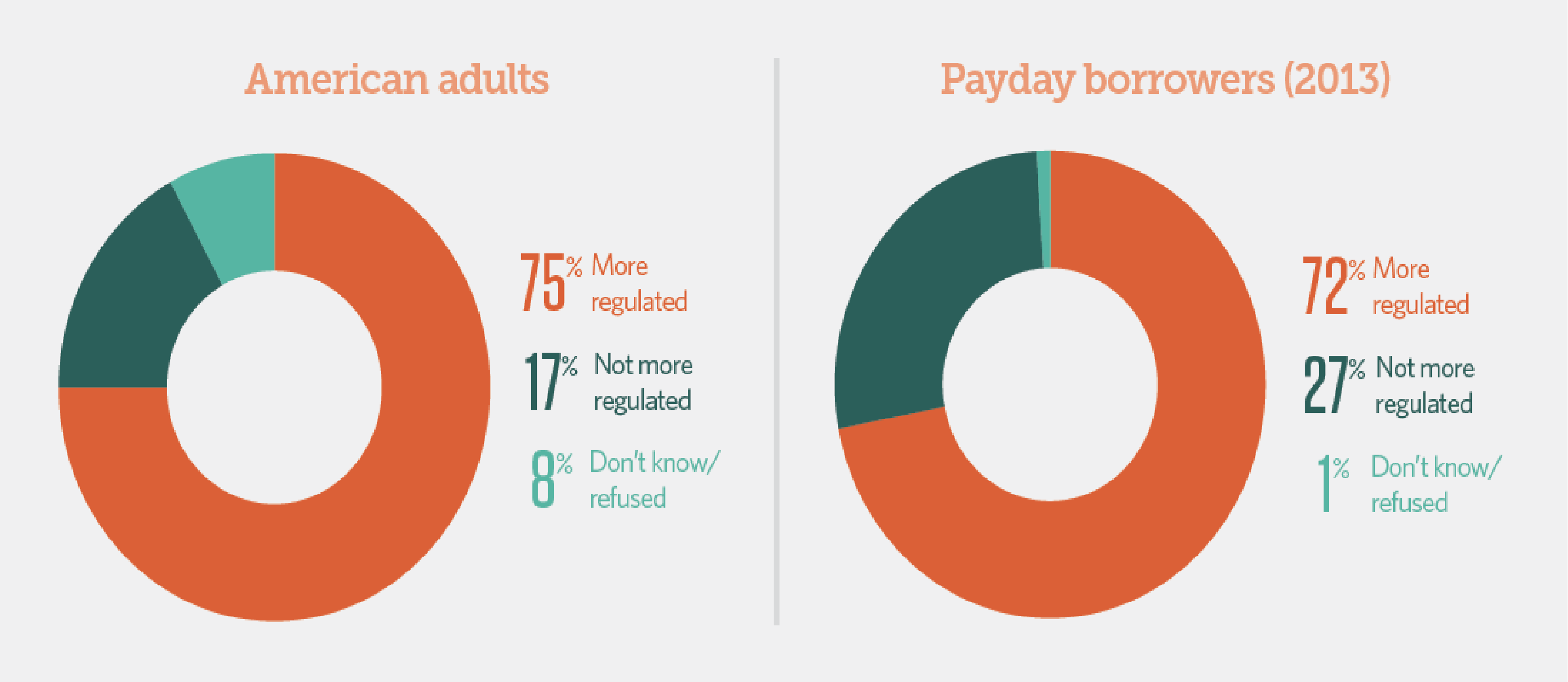
Attitudes toward financial institutions, by type



Both Borrowers and the General Public Overwhelmingly Support Payday Loan Reform

3 in 4 Americans Want Payday Loans to Be More Regulated

This finding reflects similar opinions expressed by payday borrowers



Key Takeaways

- Borrowers and the public *overwhelmingly* support payday loan reform
- CFPB will set a strong new floor
  - But will not *eliminate* high cost, non-bank lending
- There are serious risks in the high-cost installment loan market
  - States that allow it will have to work hard to control those risks
- If you have questions please contact Pew
  - Most extensive collection of research on payday, auto title, etc.
  - Recommendations for strengthening the CFPB framework
  - Analysis of risks and how state law can better contain them
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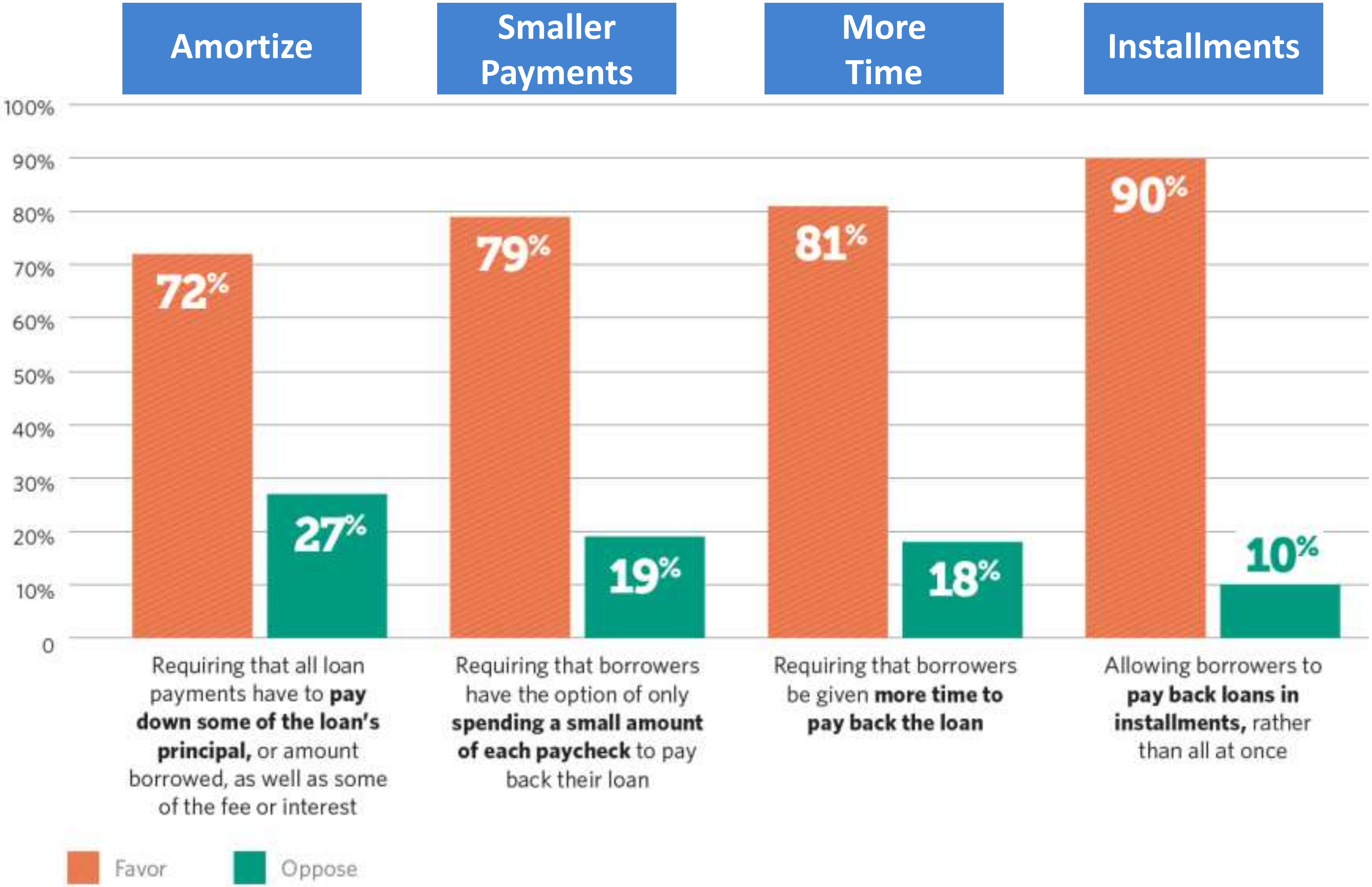
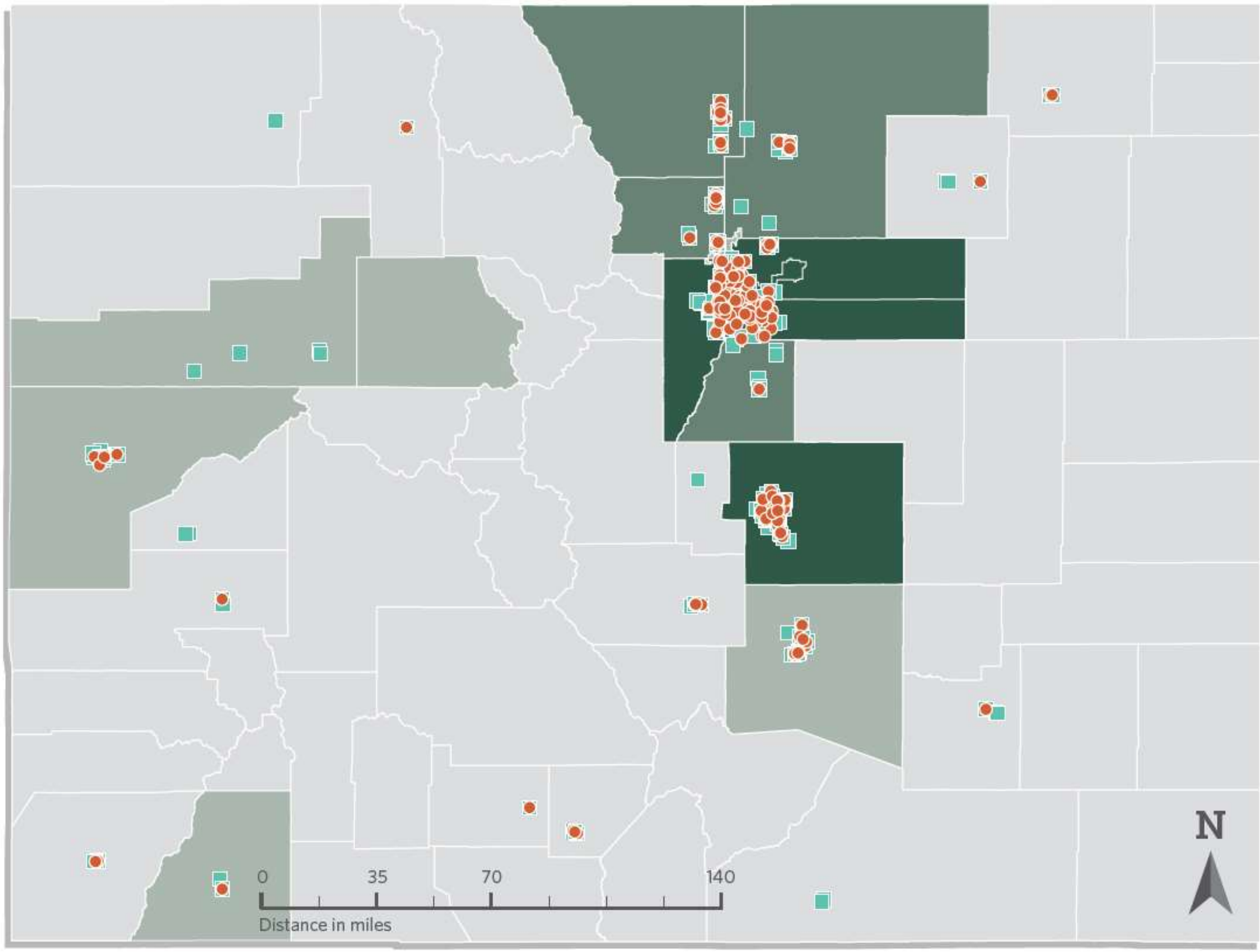
Borrowers Overwhelmingly Support Reform

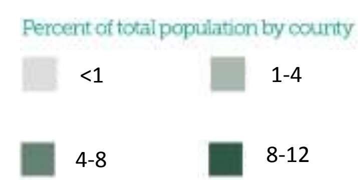


Stores Still Widely Available After Law Change



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

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



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

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