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CONSUMER FINANCIAL PROTECTION BUREAU STUDY FINDS DEBT TRAP CONCERNS WITH PAYDAY AND DEPOSIT ADVANCE LOANS

The Consumer Financial Protection Bureau (CFPB) has published a study on payday loans and deposit advance products, which are offered by a small but growing number of depository institutions. It is one of the most comprehensive analyses of the market to date. The study found that both products can lead many borrowers into a cycle of high-cost borrowing over an extended period of time. This raises substantial consumer protection concerns about debt traps.

BACKGROUND

Some consumers use payday and deposit advance loans to attain credit quickly. While easy to access, these loans are normally accompanied by high fees and repayment is tied to the consumer's subsequent paycheck or other form of regular income, like benefits. For a payday loan, if the consumer does not repay the loan in full by the due date, the loan agreement typically permits the lender to cash the consumer's check or electronically debit the account to obtain repayment. For a deposit advance, the bank will automatically repay the loan with the borrower's next qualifying electronic deposit. This structure has the ability to create a cycle of debt, in which some consumers use these services on a sustained basis. The CFPB has found similar levels of sustained use in payday and deposit advance products.

The sustained use often comes from a consumer's inability to pay back the entire loan plus the fee while having enough left over to meet their other financial obligations. When consumers cannot repay the full amount, the payday lender may either give the consumer the chance to roll over the loan balance by paying an additional fee or repay the loan in full and then immediately take out a new loan. With deposit advances, the consumer can generally re-borrow the amount repaid at any time after repayment.

Payday storefronts have been commonplace in many neighborhoods since the late 1990s, and a small but growing number of depository institutions offer deposit advance products. About 12 million households borrow money with payday loans, according to the Pew Charitable Trusts. And, according to Stephens Inc., payday lenders collect about $7 billion annually in fees from the more than 18,200 payday storefronts in the United States.

Because of the concerns already identified and the potential for growth in the market for these short-term, small-dollar credit products, the CFPB plans to study the issues further.

The CFPB report looked at a 12-month period with more than 15 million payday loans and data from multiple depository institutions. It provides an accurate representation of how these products are used by a sizeable share of borrowers in the marketplace. The purpose of the report is to facilitate discussion around a shared set of facts, and to provide market participants with a clear statement of CFPB concerns.

PAYDAY LOANS BY THE NUMBERS

- **$15 per $100 borrowed:** Median fees on a typical 14-day loan
- **$350:** Median size of a payday loan
- **391 percent:** Annual percentage rate (APR) yields on typical $15 per $100, 14-day payday loans
- **199 days:** Median number of days borrowers are indebted annually
- **10:** Median number of transactions by borrowers over 12 months
- **$458:** Median fees incurred by a payday loan consumer

DEPOSIT ADVANCE LOANS BY THE NUMBERS

- **$10 per $100 borrowed:** Typical fees on a loan
- **$180:** Median size of individual advance
- **$343:** Median outstanding balance of deposit advance loans
- **304 percent:** APR yield using the average outstanding balance period of 12 days, assuming a fee of $10 per $100
- **$3,000:** Total amount that more than half (52 percent) of all deposit advance borrowers end up taking out in a year
- **149 or more:** The number of days that customers with more than $3,000 in advances tend to be indebted
- **12 or less:** The number of days that customers with more than $3,000 in advances tend to go between paying an old balance and taking out a new advance
- **65 percent:** Percentage of consumers using deposit advances who also accrued overdraft or non-sufficient funds fees

The report found many consumers repeatedly roll over or take out additional payday loans, often on the same day as a previous one is repaid. Similarly, the average deposit advance user has breaks of less than two weeks between borrowing spells. As a result, many borrowers incur significant costs over time.

The CFPB's findings raise substantial consumer protection concerns. Specifically, the study found that a sizable share of consumers use these generally high-cost products in a sustained, rather than infrequent, way. Limited underwriting and the single payment structure of the loans may contribute to trapping consumers in debt.

LOOSE LENDING

Lenders often do not take a borrower's ability to repay into consideration when making a loan. Instead, they may rely on ensuring they are one of the first in line to be repaid from a borrower's income. For the consumer, this means there may not be sufficient funds after paying off the loan for expenses such as for their rent or groceries – leading them to return to the bank or payday lender for more money.

Payday:

- Eligibility to qualify for a payday loan usually requires proper identification, proof of income, and a personal deposit account.
- Credit score and financial obligations are generally not taken in to account.
- No collateral is held for the loan, although the borrower does provide the lender with a personal check or authorization to debit her checking account for repayment.
- One in six borrowers receive government assistance or benefits – such as Social Security, disability, unemployment or welfare benefits.

Deposit Advance:

- A customer is eligible for a deposit advance if she has a deposit account in good standing, which has been open for a specified period, and has a history of recurring electronic deposits above a minimum size. Individual depository institutions may impose additional eligibility criteria.
- A customer's ability to repay the loan while also paying other debts and ordinary living expenses is not specifically taken into account.
- As compared to those who are eligible for deposit advance but choose not to use it, borrowers generally have substantially lower average deposit balances, suggesting they have less of a buffer to deal with financial shortfalls.

RISKY LOAN STRUCTURES

The risk posed by the loose underwriting is compounded by some of the features of payday and deposit advance loans, particularly the rapid repayment structure. Paying back a lump sum instead of installments can be asking too much of an already struggling consumer, forcing them to take out another loan.

Payday:

- If the consumer does not repay the loan in full by the due date, the loan agreement typically permits the lender to cash the consumer's check or electronically debit their account to obtain repayment.
- The report finds the median loan term to be just 14 days.
- The median storefront payday loan size is $350.

Deposit Advance:

- Deposit advances permit customers to take out multiple incremental advances up to a specified credit limit prior to repayment.
- There is generally not a fixed repayment date with a deposit advance. Instead, the bank will apply any qualifying electronic deposits into the borrower's account to repay all outstanding advances.
- Depository institutions may take repayment out of subsequent incoming electronic deposits into the account if the first such deposit is not sufficient to repay the amount due.
- The financial institution may "force pay" from the borrower's account if an advance is not paid in 35 days, even if this results in the account being overdrawn.
- The report finds that deposit advance "episodes," which may include multiple advances, have a median duration of 12 days.
- The average advance a customer received was $180.
- The average outstanding balance is $343.

HIGH COSTS

Both payday loans and deposit advances are designed for short-term use and can have very high costs. These high costs can add up – on top of the already existing loans that a consumer is taking on.

Payday:

- Fees for storefront payday loans generally range from $10-$20 per $100 borrowed.
- For the typical loan of $350, for example, the median $15 fee per $100 would mean that the borrower must come up with more than $400 in just two weeks.
- A loan outstanding for two weeks with a $15 fee per $100 has an APR of 391 percent.

Deposit Advance:

- Fees generally are about $10 per $100 borrowed.
- For a deposit advance with a typical $10 fee per $100 borrowed on a typical 12-day loan, for example, the APR would be 304 percent.
- Using an average outstanding balance of $343 with a $10 fee per $100 borrowed, for example, means that more than $375 could be taken out of the borrower's next incoming qualifying deposit.

SUSTAINED USE

Payday and deposit advance products are structured as products designed to meet short-term credit needs, but the report found that some consumers are at risk of using these products to make up for chronic cash-flow shortages. This turns what is described as a costly short-term bridge into a very expensive, long-term loan. Some consumers are at risk of being caught in a revolving door of debt when they end up effectively paying a new round of fees each pay period. For consumers, it is unclear whether they fully appreciate that use of these products may be longer than the original term. Or that they could potentially pay as much or more in fees as the amount they borrow.

Payday:

- The median borrower has 10 transactions a year, while 14 percent of borrowers undertake 20 or more transactions annually.
- The average borrower paid $458 in fees (not including the loan principal) while a quarter of borrowers paid $781 or more in fees over the course of the year.
- On average, borrowers spent nearly 200 days in debt.
- About 25 percent of consumers spend over 300 days indebted.

Deposit Advance:

- More than half of all users end up borrowing more than $3,000 per year and tend to be indebted more than 40 percent of the year.
- Deposit advance users with multiple borrowing "episodes" have a median break between paying off an old balance and taking out a new advance of 13 days – suggesting they cannot make it to the next paycheck without another loan.
- Nearly two-thirds of consumers who use deposit advance products also incurred an overdraft or non-sufficient funds fee.
- Among deposit advance users who had overdraft or non-sufficient funds activity, the median user had five fees related to overdraft or non-sufficient funds.