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CONSUMER FINANCIAL PROTECTION BUREAU FINDS PAYDAY AND DEPOSIT ADVANCE LOANS CAN TRAP CONSUMERS IN DEBT

Sustained Use of Loans Raises Consumer Protection Concerns

WASHINGTON, D.C. —Today the Consumer Financial Protection Bureau (CFPB) issued a report on payday and deposit advance loans finding that for many consumers these products lead to a cycle of indebtedness. Loose lending standards, high costs, and risky loan structures may contribute to the sustained use of these products which can trap borrowers in debt.

"This comprehensive study shows that payday and deposit advance loans put many consumers at risk of turning what is supposed to be a short-term, emergency loan into a long-term, expensive debt burden," said CFPB Director Richard Cordray. "For too many consumers, payday and deposit advance loans are debt traps that cause them to be living their lives off money borrowed at huge interest rates."
The Payday Loans and Deposit Advance Products report is at:
http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf

The report found that payday loans and the deposit advance loans offered by a small but growing number of banks and other depository institutions are generally similar in structure, purpose, and the consumer protection concerns they raise. Both are typically described as a way to bridge a cash flow shortage between paychecks or other income. They offer quick and easy accessibility, especially for consumers who may not qualify for other credit. The loans generally have three features: they are small-dollar amounts; borrowers must repay them quickly; and they require that a borrower repay the full amount or give lenders access to repayment through a claim on the borrower's deposit account.

The CFPB study is one of the most comprehensive ever undertaken on the market. It looked at a 12-month period with more than 15 million storefront payday loans and data from multiple depository institutions that offer deposit advance products.

Key Finding: Payday and deposit advance loans can become debt traps for consumers

The report found many consumers repeatedly roll over their payday and deposit advance loans or take out additional loans; often a short time after the previous one was repaid. This means that a sizable share of consumers end up in cycles of repeated borrowing and incur significant costs over time. The study also confirmed that these loans are quite expensive and not suitable for sustained use. Specifically, the study found 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 checking 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. Credit score and financial obligations are generally not taken in to account.
- **Deposit Advance:** Depository institutions have various eligibility rules for their customers, who generally already have checking accounts with them. The borrower authorizes the bank to claim repayment as soon as the next qualifying electronic deposit is received. Typically, though, a customer's ability to repay the loan outside of other debts and ordinary living expenses is not taken into account.

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 when a consumer's next paycheck or other deposit arrives can be difficult for an already cash-strapped consumer, leading them to take out another loan.

- **Payday:** Payday loans typically must be repaid in full when the borrower's next paycheck or other income is due. The report finds the median loan term to be just 14 days.
- **Deposit Advance:** There is not a fixed due date with a deposit advance. Instead, the bank will repay itself from the next qualifying electronic deposit into the borrower's account. The report finds that deposit advance "episodes," which may include multiple advances, have a median duration of 12 days.

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 Annual Percentage Rate (APR) of 391 percent.
- **Deposit Advance:** Fees generally are about $10 per $100 borrowed. For a deposit advance with a $10 fee per $100 borrowed on a 12-day loan, for example, the APR would be 304 percent.

Sustained Use: The loose underwriting, the rapid repayment requirement, and the high costs all may contribute to turning a short-term loan into a very expensive, long-term loan. For consumers, it is unclear whether they fully appreciate the risk that they may end up using these products much longer than the original term. Or, that they may end up paying fees that equal or exceed the amount they borrowed, leading them into a revolving door of debt.

- **Payday:** For payday borrowers, nearly half have more than 10 transactions a year, while 14 percent undertook 20 or more transactions annually. Payday borrowers are indebted a median of 55 percent (or 199 days) of the year. For the majority of payday borrowers, new loans are most frequently taken on the same day a previous loan is closed, or shortly thereafter.
- **Deposit Advance:** More than half of all users borrow more than $3,000 per year while 14 percent borrow more than $9,000 per year. These borrowers typically have an outstanding balance at least 9 months of the year and typically are indebted more than 40 percent of the year. And while these products are sometimes described as a way to avoid the high cost of overdraft fees, 65 percent of deposit advance users incur such fees. The heaviest deposit advance borrowers accrue the most overdraft fees.

The CFPB has authority to oversee the payday loan market. It began its supervision of payday lenders in January 2012. The CFPB also has authority to examine the deposit advance loans at the banks and credit unions it supervises, which are insured depository institutions and credit unions, and their affiliates, that have more than $10 billion in assets. Today's report will help educate regulators and consumers about how the industry works and provide market participants with a clear statement of CFPB concerns.

While today's study looked at storefront payday lenders, the CFPB will continue to analyze the growing online presence of such businesses. The Bureau is also looking at bank and credit union deposit account overdraft programs which provide short-term, small-dollar, immediate access credit services. The CFPB will publish initial results from this overdraft study later this spring.

To help educate consumers about payday and deposit advance loans, today the CFPB updated its Ask CFPB web tool to assist consumers with their financial questions about these products.

A factsheet about payday and deposit advance loans is available at:
http://files.consumerfinance.gov/f/201304_cfpb_payday-factsheet.pdf

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The Consumer Financial Protection Bureau is a 21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing those rules, and by empowering consumers to take more control over their economic lives. For more information, visit consumerfinance.gov.