

Frequently Asked Questions: The Real Deal on Payday Loans

Q: What is the alternative? Where will people go?

A: The most common reason people take out a new payday loan is to fill their family budget gap caused by the old payday loan.¹ Ending 400% payday loans means they will no longer be stuck in this debt trap. Borrowers consistently report having a range of options to manage the fact that income is not sufficient to cover basic expenses. Borrower-reported options include signature loans, credit cards, credit unions, friends, families, churches, relief societies, and savings, all at a fraction of the cost of payday loans.² All of these options exist in Arizona.

Q: Don't payday loans help people?

A: No. Payday loans are a stepping stone into long term debt. A typical payday borrower in Arizona pays **\$841 to borrow \$325**.³ That's a lot of money that could be used for food, clothing, or savings. Studies find that payday loans are more likely to cause bankruptcy, default on rent and utility bills, & involuntary bank account closures.⁴

Q. Why should the cost of the loan be in terms of annual percentage rate (APR) if it is just a two week loan?

A. APR matters for payday loans. This is the only way consumers can compare the cost of credit. It allows apple-to-apple comparisons and protects free market competition.⁵ And, it is not at two week loan.

Q. Won't a database help?

A. No. Databases do not stop the debt trap. They simply track bad products. Even in states with databases, and other reforms such as renewal bans, loan limits, cooling off period, repayment plans etc., the average borrower is indebted to the payday lender for an average of 4.5 months for a typical \$300 loan and pays hundreds of dollars in fees.⁶ The database will merely serve as an ineffective regulatory burden for the resource-strapped state to track bad loans.

Q. Won't enforcing 400% cause a loss in tax revenue?

A. No. The loss in fees paid to mostly out of state payday loan companies - \$150 million - dwarfs any asserted claims of taxes paid. Numbers currently being used by the industry are from a report paid for by their trade association, and the analysis looks only at revenues paid but not overall cost to the state. That \$150 million in payday lending fees every year represents lost opportunities, not only for the families who could have used that money for basic needs, but for other Arizona businesses. The only thing we'll lose by letting the sunset is a high cost defective loan product which results in good money constantly being thrown after bad.

Q. Won't enforcing 400% cause a loss of jobs?

A. Threats of job loss are highly exaggerated. The turnover is extremely high, with annual turnover reaching as high as 80% for payday lending employees.⁷ In some cases, approximately 50% of turnover for storefront managers and employees occurred within the first 6 months of their hire date. In other, words it's likely that the people working in payday stores today won't be there by July 1, 2010 anyway.

And, and for every payday lending employee, 179 consumers are caught in the cycle of debt.⁸ Letting the sunset on 400% simply means that these companies can no longer offer this defective product. As has happened in other states, they certainly have the choice to keep their doors open by offering other products and services which comply with Arizona's laws.

Q. Doesn't ending 400% on payday loans violate free market principles?

A. No. We have seen how expensive, easy and out of control debt made with no consideration of ability to repay has crippled our economy. Payday loans are no different. The business model depends on customers not being able to repay their loan, meaning it's basically a defective loan product. Additionally, this product operates via a special exemption from the state's uniform cap for consumer loans. Ending a special carve-out for 400% loans creates a level playing field for consumer lenders and preserves free market principles, not undermines them.

Q. Aren't payday loans better than overdraft fees?

A. No. Overdraft fees and payday loans are both usurious practices that need to be addressed. But, payday loans and overdrafts are not substitutes. Overdrafts are caused by small accidental purchases often \$20, not large amounts such as \$300 like payday loans.⁹ When someone defaults on a payday loan they will incur both insufficient fund fees from the payday lender and overdraft fees from their bank. Payday loans don't ease the burden of overdraft fees, they increase them

¹ Leslie Parrish and Uriah King, *Phantom Demand*, Center for Responsible Lending (June 2009) available at <http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-short-term-due-date-generates-need-for-repeat-payday-loans-accounting-for-76-of-total-volume.html>.

² University of North Carolina Center for Community Capital. *North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options*. (Nov. 2007) available at http://www.ccc.unc.edu/abstracts/1107_NorthCarolina.php.

³ Leslie Parrish, *High Cost Payday Lending Traps Arizona Borrowers*, Center for Responsible Lending (Sept. 18, 2008) available at <http://www.responsiblelending.org/pdfs/high-cost-of-payday-in-arizona.pdf>.

⁴ Paige Marta Skiba (Vanderbilt) and Jeremy Tobacman (U. Pennsylvania), *Do Payday Loans Cause Bankruptcy?* (Oct. 10, 2008); Brian T. Melzer (PhD Candidate, Economics, U. of Chicago Business School), *The Real Costs of Credit Access: Evidence from the Payday Lending Market* (Nov. 15, 2007); Dennis Campbell, Asis Martinez Jerez, and Peter Tufano (Harvard Business School). *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures* (June 6, 2008).

⁵ According to the Federal Reserve, "payday loans . . . constitute credit for purposes of TILA" (the Truth in Lending Act). One purpose of TILA is "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the unintended use of credit . . ." 15 U.S.C. 1601(a). A central disclosure requirement of TILA is the APR.

⁶ Parrish, *supra* note 3.

⁷ See e.g., Advance America 2007 10K at page 27, "As of December 31, 2007, the annual turnover among our center managers was approximately 58% and among our other center employees was approximately **120%**. Approximately 50% of the turnover has traditionally occurred in the first six months following the hire date of our center managers and employees." <http://investors.advanceamerica.net/secfiling.cfm?filingID=1047469-08-2021>. See also Advance America 2008 10K at page 28, "As of December 31, 2008, the annual turnover among our center managers was approximately 38% and among our other center employees was approximately **94%**. Approximately 47% of the turnover has traditionally occurred in the first six months following the hire date of our center managers and employees." <http://investors.advanceamerica.net/secfiling.cfm?filingID=1047469-09-2196>

⁸ The FDIC reports that the median number of full-time employees per store is 2 for a young store and 3 for a mature store. For conservative estimate of how many Americans are caught in a cycle of debt per payday employee, we calculate 3 employees per store (about 22,000). FDIC Center for Financial Research Working Paper No. 2005-09, "*Payday Lending: Do the Costs Justify the Price?*", Mark Flannery, Katherine Samolyk (June 2005).

⁹ Center for Responsible Lending, "*Payday Puts Families in the Red*," (Feb. 2009), available at <http://www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf>. See also, NC Commissioner on Banks, "2000 Annual Report Of Check Cashing Businesses Licensed Under Article 22 Of Chapter 53 Of The North Carolina General Statutes Fact Sheet," (reporting that payday lenders collected over \$2 million in insufficient fund fees in the last year of operations in NC), available at <http://www.nccob.org/NR/rdonlyres/5F7F31CF-2645-4CD2-8EE1-EE349F9F6AE8/0/cccon00.pdf>.

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