IN THE UNITED STATES DISTRICT COURT
FOR THE STATE OF DELAWARE

EDMUND ZIEGER, on behalf of himself and all others similarly situated, Plaintiff, v. ADVANCE AMERICA, CASH ADVANCE CENTERS, INC. d/b/a ADVANCE AMERICA, NCAS OF DELAWARE, LLC d/b/a ADVANCE AMERICA, Defendants.	)	C.A. No. CLASS ACTION

VERIFIED CLASS ACTION COMPLAINT

Plaintiff EDMUND ZIEGER ("Zieger" or "Plaintiff"), on behalf of himself and all others similarly situated, alleges as follows:

Nature of Action

1. This is an action seeking temporary, preliminary and permanent injunctive relief, declaratory relief, recovery of compensatory, consequential, and punitive damages, reasonable attorneys' fees and costs, and other relief arising from defendants' wrongful and unconscionable conduct, unjust enrichment, aiding and abetting, civil conspiracy, breaches of the duty of good faith and fair dealing, and violations of 6 Del. C. § 2513 (the "Delaware Consumer Fraud Act").

2. Defendants are ADVANCE AMERICA, CASH ADVANCE CENTERS, INC., and NCAS OF DELAWARE, LLC (Advance America, Cash Advance Centers, Inc. and NCAS of Delaware, LLC collectively d/b/a ADVANCE AMERICA and referred to herein collectively as "Advance" and "Defendants").

3. Plaintiff was a borrower who took a loan from Advance under unconscionable terms and conditions.

4. Advance America burdens borrowers with loans containing interest rates of greater than 350% APR but then expressly and repeatedly discourages customers from looking at this information by advertising to and advising their customers that the disclosed APR "doesn't matter" and that the APR isn't an appropriate measure of how much customers are paying. See Exhibit A.

5. On August 8, 2013, Zieger borrowed $650.00 from Advance. Under the terms of the agreement, Zieger was obligated to repay $1,496.94 representing the principal of $650.00 together with interest of $846.94. The annual interest rate of this loan: 387.16%.

6. Additionally, Advance had Zieger grant it authorization for Advance to make automatic withdrawals from his bank account via the ACH system, and release important rights of due process, including the right to a jury trial, or the right to participate in a class action.

7. Zieger receives social security disability of approximately $1,444.60 every month. Under the terms of the loan, Advance takes automatic withdrawals from Zieger's bank account of $249.50 every month for the next six months.

The Parties

8. Plaintiff EDMUND ZIEGER is a natural person residing at 40 Delvin Terrace, Wilmington, Delaware 19805. He incurred a loan from Advance on or about August 8, 2013.

9. Defendant ADVANCE AMERICA, CASH ADVANCE CENTERS, INC. is a Delaware corporation – whose registered agent in Delaware is the Corporation Service Company, with an address of 2711 Centerville Road, Suite 400, Wilmington, Delaware 19808. On information and belief, ADVANCE AMERICA, CASH ADVANCE CENTERS, INC. operates in Delaware through its entity NCAS of Delaware, LLC, a Delaware limited liability company – whose registered agent in Delaware is the Corporation Service Company, with an address of 2711 Centerville Road, Suite 400, Wilmington, Delaware 19808. Advance America, Cash Advance Centers, Inc. and NCAS of Delaware, LLC collectively d/b/a ADVANCE AMERICA.

Jurisdiction and Venue

10. This Court has exclusive jurisdiction over this civil action pursuant to 28 U.S.C. § 1332(d)(2) because the controversy exceeds the sum of $5,000,000, exclusive of interest and costs, and one of the members of the class of plaintiffs is a citizen of a State different than one of the Defendants, and Plaintiff believes there are more than 100 class members.

11. Venue is proper in this judicial district pursuant to 28 U.S.C. § 1391(b)(2) as a substantial part of the events giving rise to Plaintiff's claims occurred in this judicial district and pursuant to 28 U.S.C. § 1391(b)(1) as the Defendants are both residents of Delaware.

Background

12. Advance is engaged in the business of marketing, advertising, and making "payday loans," and "installment loans" and regularly makes such loans within and without the State of Delaware.

13. Zieger borrowed $650.00 from Advance.

14. Advance's loans are advertised as a "safety net" and helping with unexpected and periodic financial difficulty. While Advance says that such loans are "not recommended for long-term financial solutions," they know that many borrowers extend the loans in a cycle of debt. Advance America expressly and repeatedly discourages customers from looking at APR information in the loans by advertising to and advising their customers that the disclosed APR "doesn't matter" and that the APR isn't an appropriate measure of how much customers are paying.

15. Prominent organizations such as the Pew Charitable Trusts and the Insight Center for Community Economic Development have studied the effects of payday lending, and published findings concluding that the practice has a harmful effect not only on borrowers' finances and credit, but on the broader economy. An in-depth study published by the Pew Charitable Trusts in 2012 discussed the payday loan industry and the effects of such loans on borrowers and society. The study found that, while payday loan companies market their products as "payday," or short-term loans, the average initial loan is rolled over again and again, and remains open for five months of the year. Researchers found that payday lenders build their business models on the premise that borrowers cannot repay the loans in a two-week period, and that the loans become extremely profitable (to the lender) when it becomes a long-term debt. Researchers at the Federal Reserve Bank of Kansas City concluded that, "the profitability of payday lenders depends on repeat borrowing." A copy of the Pew Charitable Trusts report is attached hereto as Exhibit B. A second report was issued in 2013. A copy is attached as Exhibit C.

16. The U.S. Office of the Comptroller of the Currency (the "OCC") provided testimony to the U.S. House of Representatives in 2012 in which the OCC called payday loans "unsafe and unsound and unfair to consumers" and noting that profitability "is dependent on effectively trapping consumers in a cycle of repeat credit transactions, high fees, and unsustainable debt." See letter to the FDIC and OCC by AARP, Center for Responsible Lending, Consumer Federation of America, Leadership Conference on Civil and Human Rights, NAACP and National Consumer Law Center attached as Exhibit D at p. 4, see also, May 29, 2012 letter from FDIC to Americans for Financial Reform as Exhibit E hereto.

17. In 2006, the FDIC Office of the Inspector General issued a report entitled, *Challenges and FDIC Efforts Related to Predatory Lending* (Report No. 06-011) (Exhibit F hereto.) While recognizing that there is no universally accepted definition of predatory lending, the FDIC stated the practice "typically involves imposing unfair and abusive loan terms on borrowers, often through aggressive sales tactics; taking advantage of borrowers' lack of understanding of complicated transactions; and outright deception." The FDIC identified characteristics associated with predatory lending, many of which are applicable here: (1) balloon payments with unrealistic repayment terms; (2) encouragement of default in connection with refinancing; (3) excessive fees not justified by the costs of services provide and the credit and interest rate risks; (4) excessive interest rates; (5) fraud, deception and abuse; (6) lending without regard to ability repay; (7) mandatory arbitration clauses; (8) ***payday lending***; (9) repetitive refinancing.

18. Costly debt terms drain borrowers' limited cash needed to cover basic living expenses such as rent and food. Costly debt also impairs a borrower's ability to save,

invest or otherwise spend on worthwhile consumer goods. Onerous debt terms also increase the chances that a borrower will incur overdraft fees and other bank charges, and file for personal bankruptcy. Indeed, at least fifteen states have banned payday lending, and Congress has prohibited payday lenders from targeting members of the military.

Defendants' Practices

19. For years, Advance has marketed, advertised and made loans to residents inside and outside of Delaware, including Plaintiff.

20. Advance aggressively markets and advertises these loans as short-term credit solutions and not as a source of ongoing help. Advance says that these loans are meant as a "safety net" while expressly and repeatedly discouraging borrowers from considering the high APR of the loan – which they are required to disclose under the Truth-in-Lending-Act - claiming that the APR is "massively misleading." See Exhibit A hereto.

21. For years, Advance has derived substantial revenues and profits from the sale of such loans in Delaware and elsewhere. "Payday" loans are only profitable to the lender when the short-term loan becomes a long-term obligation. Advance acknowledges that "borrowers often use these loans over a period months which can be expensive." As a result of the policies and practices of Advance, borrowers are routinely trapped in products that cause harm, including financial loss, hardship, and damage to personal credit.

22. Advance intends to induce borrowers to enter into short-term loans, knowing that borrowers will likely extend the terms of the loans. As the 2013 Pew report notes, lenders such as Defendant "rely on borrowers to use the loans for an extended period of time . . . in order to be profitable. . . ." Exhibit C at 19. As the OCC testified before the

U.S. House of Representatives, profitability "is dependent on effectively trapping consumers in a cycle of repeat credit transactions, high fees, and unsustainable debt." Exhibit D at p. 4.

23. Advance hides the fact that they intend, and expect borrowers, including Plaintiffs, to repay the loan on extended payment terms and pay exorbitant interest rates, sometimes exceeding 350% of the principal amount of the loan.

24. There is no limit to the amount that a borrower will pay unless and until the borrower repays the loan in full, including interest and any and all other fees pursuant to the terms of the loan document. Initial short-term obligations stretch into a never ending cycle of inescapable debt.

25. Advance entered into an agreement with Plaintiff knowing that the overwhelming majority of their borrowers are unable to pay loans in a short-term and at substantial and undue cost to borrowers. On information and belief, Advance does no underwriting or analysis of whether a borrower can afford to repay the loan.

26. Advance preys on borrowers who can be induced, like Plaintiff, to enter into an unconscionable loan, knowing that the borrower is at a significant disadvantage to negotiate fair terms and knowing that these loans exacerbate those problems.

27. Advance knowingly uses its significant leverage to induce borrowers, including Plaintiff, to enter into loans with excessive, onerous and unconscionable terms. Indeed, the interest and penalties of borrowers' loans, including Plaintiff's loans, dwarf the principal amount of the loans.

28. On a "take-it-or-leave-it basis," Advance uses its significant leverage to cause borrowers, including Plaintiff, to accept the onerous, outrageous and unconscionable

boilerplate terms, including terms that significantly, if not wholly, impaired Plaintiff's rights to due process under law. For instance, this includes:

a. Small font size;

b. Boilerplate forms;

c. Interest rates typically exceeding 350%;

d. Hard to understand contract language;

e. ACH authorizations that allow Defendants to automatically withdraw varying amounts from the borrower's bank account without warning;

f. Late charges / delinquency charges;

g. Arbitration clauses (which effectively waives the right to a jury);

h. Class action waivers.

The meaning of these terms and the implication of agreeing to these terms are incomprehensible to a layperson, and particularly borrowers who typically use "payday loans." Plaintiff did not understood the implication of all of these terms.

29. Advance knowingly exploits its sophistication and its counterparty's equal lack of sophistication, lack of understanding and lack of bargaining ability, to impose unconscionable loan terms and unconscionable purported waivers of due process rights.

Advance's Contracts are Unconscionable

30. Plaintiff's loan document evidence on its face a gross imbalance in the parties' respective rights and obligations, and an exploitation of an underprivileged, unsophisticated borrower.

31. The Delaware Chancery Court, in the context of reviewing a contract under the uniform commercial code, has considered ten factors as an aid to determine whether a contract is unconscionable and unenforceable:

> 1. The use of printed form or boilerplate contracts drawn skillfully by the party in the strongest economic position, which establish industry wide standards offered on a take it or leave it basis to the party in a weaker economic position.
>
> 2. A significant cost-price disparity or excessive price.
>
> 3. A denial of basic rights and remedies to a buyer of consumer goods.
>
> 4. The inclusion of penalty clauses.
>
> 5. The circumstances surrounding the execution of the contract, including its commercial setting, its purpose and actual effect.
>
> 6. The hiding of clauses which are disadvantageous to one party in a mass of fine print trivia or in places which are inconspicuous to the party signing the contract.
>
> 7. Phrasing clauses in language that is incomprehensible to a layman or that divert his attention from the problems raised by them or the rights given up through them.
>
> 8. An overall imbalance in the obligations and rights imposed by the bargain.
>
> 9. Exploitation of the underprivileged, unsophisticated, uneducated and the illiterate.
>
> 10. Inequality of bargaining or economic power.
>
> Fritz v. Nationwide Mutual Ins. Co., 1990 WL 186448 at * 4-5 (Del. Ch. 1990)

32. The Delaware Supreme Court has held that a contract is unconscionable if it is "such as no man in his senses and not under delusion would make on the one hand, and as no honest or fair man would accept, on the other" or "whether the provision amounts to taking of an unfair advantage by one party over the other." See Tulowitzki v. Atlantic

Richfield Co., 396 A.2d 956, 960 (Del. 1978); see also, Fritz v. Nationwide Mutual Ins. Co., 1990 WL 186448, *4-5 (Del. Ch. 1990).

33. While not all of the factors are necessary to find unconscionability, all of the above factors are present with respect to the payday loans at issue in this case.

Allegations Specific To
Plaintiff EDMUND ZIEGER

34. Plaintiff incorporates by reference the foregoing paragraphs as if fully set forth herein.

35. Plaintiff EDMUND ZIEGER entered into a loan agreement with Defendant NCAS OF DELAWARE, LLC d/b/a ADVANCE AMERICA on or about August 8, 2013. A true and correct copy of the loan agreement is attached hereto as Exhibit G. This loan was the one of several payday loans that Zieger has taken as part of a cycle of long-term debt on what was advertised as a short-term solution.

36. Plaintiff borrowed $650. At the time he borrowed the principal, he did not understand fully the financial or legal terms of his loan document, contained in a single-spaced document written in what appears to be 11 point font. He did not understand that he had a right of rescission, or a right to decline ACH authorization. He did not understand that he was committing to arbitration unless he opted out. He did not understand how to opt out of the arbitration clause. He had no knowledge of these legal rights, or the statutory obligations of Advance.

37. The loan is a financial burden that will harm Zieger's ability to pay rent, purchase food, and otherwise cover basic living expenses.

38. Zieger is now locked into a long-term obligation with exorbitant interest rates, penalties and terms.

Class Certification Allegations

39. This action is brought and may properly be maintained as a class action pursuant to Fed. Civ. P. R. 23. Plaintiff is typical of members of the Class (hereinafter, the "Class"), Plaintiff brings this action on behalf of himself and all others similarly situated, as representative of a proposed Class, because the proposed Class is so numerous that the individual joinder of all its members is impracticable, common questions of law and fact exist as to all members of the proposed Class, and Plaintiffs' claims are typical of the claims of the members of the proposed Class.[1]

40. Plaintiffs anticipate seeking class certification for a class containing all of those persons who entered into loans with Advance that contain unconscionable terms as described in this complaint, including paragraph 47 of this complaint.

41. Plaintiffs anticipate seeking class certification for a class containing all of those persons who entered into loans where Defendants Wells Fargo and Bank of America provided funding to the payday lender where the loans contain unconscionable terms as described in this complaint, including paragraph 29 of this complaint.

Irreparable Harm to Plaintiff

42. Plaintiff incorporates by reference the foregoing averments as if fully set forth herein.

43. Without immediate injunctive relief, Plaintiff will be irreparably harmed by the unconscionable terms and conditions of Advance's loan.

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[1] Plaintiffs' allegations for class certification do not constitute a motion for class certification, and Plaintiffs reserve the right to file a motion for class certification at the appropriate time.

44. If Advance is permitted to continue to enforce its unconscionable terms, which include automatically withdrawing from Plaintiff's bank account, Plaintiff will face grave financial harm, including possible default on financial obligations such as rent, food and other important costs of living.

45. While the compensatory damages (for excessive interest, penalties) are possible to quantify, consequential damages resulting from Advance's continued imposition of unconscionable interest and penalties, and Advance's continued draw on Plaintiff's bank accounts, are impossible to quantify with any reasonable degree of certainty, and could not necessarily be remedied by a monetary judgment.

46. Further, the balance of hardships is in Plaintiff's favor. The total principal borrowed is $650, repayment of which is causing hardship to Zieger while Advance is among the leading payday lenders with hundreds of millions in loans.

47. Plaintiffs respectfully submit that the contract with Advance is unconscionable. Advance is taking unfair advantage of Plaintiff and all others similarly situated, and unjustly enriching itself.

48. The public interest is served if the Court enjoins enforcement of an unconscionable loan agreement. Further, enjoining Advance from enforcing an unconscionable agreement will prevent imminent and real financial harm to Plaintiff, and allow Plaintiff to focus his limited financial resources on daily living expenses like rent and food. Finally, Plaintiff is typical of the Class and those who borrow from Advance in that he is the very type of unsophisticated borrower who does not understand fully the financial implications of the loan agreements and the predatory practices of Advance. Enjoining Advance from enforcing an unconscionable agreement serves the public

interest because it protects Plaintiff and the Class from Advance's predatory and unconscionable lending practices.

COUNT I
Temporary Restraining Order (TRO), Preliminary and Permanent Injunction

49. Plaintiff incorporates by reference the foregoing averments as if fully set forth herein.

50. Advance's loan documents evidence on their face a gross imbalance in the parties' respective rights and obligations, and the exploitation of an underprivileged, unsophisticated borrower, and the existence of an unconscionable agreement: The principal amount of Advance's loan to Zieger is $650. The yearly interest rate is 387.16%. Zieger is locked into a loan that will take 6 months to repay and he would repay a total of $1,496.94 under the terms of the agreement (if he were able to make all payments on time). An ACH payment that is denied results in a penalty of $15 and if more than three payments are late, the entire balance becomes immediately due.

51. Given the size of Advance's business, it will suffer little harm if it ceases taking payments from Zieger, as the principal amount of the loan was $650.

52. Plaintiffs request that the Court enter a temporary restraining order, preliminary injunction, and permanent injunction that enjoins Advance from collecting anything more on unconscionable contracts with Plaintiff and all other Class members.

COUNT II
Declaratory Judgment

53. Plaintiff, on behalf of himself, and the Class, repeats and incorporates by reference the averments set forth above as if fully set forth herein.

54. Plaintiff contends, on behalf of himself and the class, that the loan agreement is unconscionable and unenforceable.

55. Defendants contend that the loan agreement is not unconscionable and is enforceable.

56. An actual controversy exists involving the rights or other legal relations of Plaintiff (and the class) and Defendants. The controversy is between Plaintiff (and the class) and Defendants, and their interests are real and adverse. The issue involved in the controversy is ripe for judicial determination.

57. By reason of the foregoing Plaintiff (and the class) are entitled to a declaratory judgment declaring that the loans are unconscionable and unenforceable.

COUNT III
Breach of the Duty of Fair Dealing

58. Plaintiff, on behalf of himself and the Class, repeats and incorporates by reference the averments set forth above as if fully set forth herein.

59. Advance have failed and refused to deal fairly with Plaintiff, and with all others similarly situated, in connection with Advance's business practices and imposing the unconscionable terms of the loan agreements.

60. As a direct result of Defendant's breaches of its duty of fair dealing, Plaintiff and the Class have suffered and will suffer injury as heretofore alleged.

COUNT IV
Violation of the Delaware Consumer Fraud Act

61. Plaintiff, on behalf of himself and the Class, incorporates by reference the averments set forth above as if fully set forth herein.

62. Advance's conduct, as alleged above, is in violation of 6 Del. C. § 2513.

63. Specifically, as set forth herein, Defendant has engaged in deception, fraud, false pretense, false promise, misrepresentation, concealment, suppression or omission of material facts with its customers, with the intent that their customers rely on such conduct in connection with the sale or advertisement of its products.

64. As a direct result of Defendant's violations of 6 Del. C. § 2513, Plaintiff and the Class have suffered and will suffer injury as heretofore alleged.

COUNT V
Unjust Enrichment

65. Plaintiff, on behalf of himself and the Class, incorporates by reference the averments set forth above as if fully set forth herein.

66. Advance makes millions of dollars in revenues and profits from the practices described herein. Defendant's practices are unconscionable and unjustified, and no reasonable person knowingly would impose or accept the terms and conditions of the loans made by Advance. Meanwhile, Plaintiff, and similarly situated borrowers, struggles to make payments in accordance with the terms of these loans, is exposed to overdraft fees, limited in his ability to afford basic necessities. Advance profits richly from this scheme. If the Court concludes the loans are unconscionable or illegal, Plaintiff has no adequate remedy at law for redress.

WHEREFORE, Plaintiff, on behalf of himself and the Class, respectfully requests that this Court enter judgment as follows:

a. Granting a temporary restraining order and preliminary injunction barring Advance from taking funds from Plaintiff's account;

b. Granting a permanent injunction barring Advance from taking funds from Plaintiff's account and the accounts of the Class;

c. Declaring the loan agreement used by Defendant as unconscionable and unenforceable as to Plaintiff and the Class and awarding Plaintiff and the Class all amounts Plaintiff and the Class borrowed from, and paid to, Defendant pursuant to their loan agreements;

d. Entering an Order certifying the plaintiff Class, appointing Plaintiff as representative of that Class, and appointing undersigned counsel to represent that Class, all pursuant to Fed. R. Civ. P. 23;

e. Awarding to Plaintiff, and the Class, damages, including compensatory damages, consequential and incidental damages, for Defendants' violation of the duty of good faith and fair dealing and Defendants' violation of 6 Del. C. § 2513;

f. Entering an Order requiring the disgorgement by Advance of all interest, fees and revenue earned as a result of Defendant's conduct described herein;

g. Awarding to Plaintiff, and the Class, punitive damages for Defendant's willful bad faith conduct;

h. Awarding to Plaintiff, and the Class, pre- and post-judgment interest;

i. Awarding to Plaintiff, and the Class, all costs of this action, including reasonable attorney fees;

j. Awarding such other and further relief as this Court deems just, equitable and appropriate.

Dated: September 25, 2013

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Exhibit A

ADVANCE AMERICA
You advance America

Start Your Payday Loan
Application Now: Zip code
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Consumer Issues

Loans.org: Why the APR of Payday Loans Doesn't Matter

Published: 7/15/2013, Section: Consumer Issues | In The News

Loans.org: Why the APR of Payday Loans Doesn't Matter
By Isaac Juarez
June 26, 2013
Loans.org

Getting a payday loan sounds more and more like borrowing a financial ticking time bomb than money.

Most media coverage talks about how "this legislation" or "that legislation" will curb or ban payday loans. This war on payday loans has been raging across the country ever since the cash advance lending industry began booming in both the online and offline realms.

Politicians have been forced to define their positions on the matter, some claiming support, while others fight against short-term loans for people in need.

However, politicians aren't the only voices in this debate.

Aside from politicians and the cash advance industry, consumer activists are the third voice in this three-party scuffle. One argument that consumer activists constantly use against borrowing payday loans is the high annual percentage rate (APR) that comes with obtaining these types of financing. However, calculating the APR of cash advances is a completely erroneous use of interest rate calculation for a loan lasting a matter of days.

The first casualty in a war is Truth, and in the Payday Loan War that idiom unfortunately proves to be accurate.

APRs and Interest are Apples and Oranges

Payday loan APRs can be quite high on paper, but their importance for short-term loans is massively misleading. Unfortunately, anti-payday loan voices often disregard the true correlation (or lack thereof) between annual percentage rates and cash advances.

Click here to read the full article.

Consumer Issues
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ertain limitations apply. Subject to approval. See your local store for details. More details and disclosures about payday advances per state are available online by reading Advance merica's fees and terms. See center or specific state selection for more details and additional disclosures. A single payday advance is typically for two to four weeks. However, orrowers often use these loans over a period of months, which can be expensive. Payday advances are not recommended for long-term financial solutions.

Exhibit B

THE PEW CHARITABLE TRUSTS

PAYDAY LENDING
IN AMERICA:

Who Borrows, Where They Borrow, and Why

This report series, *Payday Lending in America*, presents original research findings from the Pew Safe Small-Dollar Loans Research Project on how to create a safe and transparent marketplace for those who borrow small sums of money.

www.pewtrusts.org/small-loans

JULY 2012

The Pew Charitable Trusts is driven by the power of knowledge to solve today's most challenging problems. Pew applies a rigorous, analytical approach to improve public policy, inform the public, and stimulate civic life.

The Safe Small-Dollar Loans Research Project focuses on small-dollar credit products such as payday and automobile title loans, as well as emerging alternatives. The project works to find safe and transparent solutions to meet consumers' immediate financial needs.

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The report benefited from the insights and expertise of an external reviewer, Alan M. White, professor of law at Valparaiso University. Additionally, survey research expert Mike Mokrzycki provided us with valuable feedback in designing our survey and methodology. Although they have reviewed the report, neither they nor their organizations necessarily endorse its findings or conclusions.

For additional information, visit www.pewtrusts.org/small-loans

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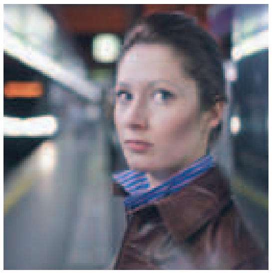
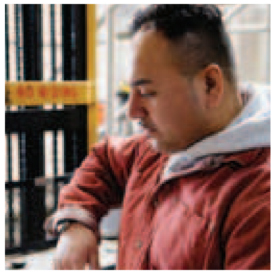
Executive Summary

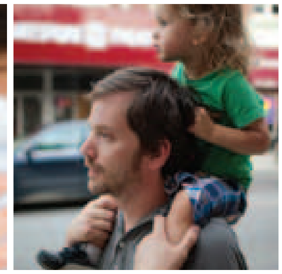
Payday loan borrowers spend approximately $7.4 billion[1] annually at 20,000 storefronts and hundreds of websites, plus additional sums at a growing number of banks. The loans are a highly controversial form of credit, as borrowers find fast relief but often struggle for months to repay obligations marketed as lasting only weeks.[2] While proponents argue that payday lending is a vital way to help underserved people solve temporary cash-flow problems, opponents claim that the practice preys on overburdened people with expensive debt that is usually impossible to retire on the borrower's next payday.

Many state officials have acted to curb payday lending. However, there has been little opportunity for federal policy on payday lending until now. Resolving the debate over the ways in which payday loans and lender practices may help or harm borrowers will fall to the Consumer Financial Protection Bureau (CFPB), which Congress recently created and charged with regulating payday lending. Other federal agencies, such as the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and Federal Trade Commission (FTC), also will have important roles to play as banks and online providers continue to enter the payday loan field.[3]

Existing data show that, in at least two significant respects, the payday lending market does not function as advertised. First, payday loans are sold as two-week credit products that provide fast cash, but borrowers actually are indebted for an average of five months per year. Second, despite its promise of "short-term" credit, the conventional payday loan business model requires heavy usage to be profitable—often, renewals by borrowers who are unable to repay upon their next payday. These discrepancies raise serious concerns about the current market's ability to provide clear information that enables consumers to make informed decisions.

This report, ***Who Borrows, Where They Borrow, and Why***, is the first in Pew's *Payday Lending in America* series. The findings provide policy makers with research to address concerns about small-dollar loans and to promote a safe and transparent marketplace. In addition to discussing Pew's focus groups, the report presents selected results from a first-ever nationally representative telephone survey of payday borrowers. The report answers six major questions: Who are borrowers, demographically? How many people are borrowing? How much do they spend? Why do they use payday loans? What other options do they have? And do state regulations reduce payday borrowing or simply drive borrowers online instead?



Key Findings

1 Who Uses Payday Loans? Twelve million American adults use payday loans annually. On average, a borrower takes out eight loans of $375 each per year and spends $520 on interest.

Pew's survey found 5.5 percent of adults nationwide have used a payday loan in the past five years, with three-quarters of borrowers using storefront lenders and almost one-quarter borrowing online. State regulatory data show that borrowers take out eight payday loans a year, spending about $520 on interest with an average loan size of $375. Overall, 12 million Americans used a storefront or online payday loan in 2010, the most recent year for which substantial data are available.

Most payday loan borrowers are white, female, and are 25 to 44 years old. However, after controlling for other characteristics, there are five groups that have higher odds of having used a payday loan: those without a four-year college degree; home renters; African Americans; those earning below $40,000 annually; and those who are separated or divorced. It is notable that, while lower income is associated with a higher likelihood of payday loan usage, other factors can be more predictive of payday borrowing than income. For example, low-income homeowners are less prone to usage than higher-income renters: 8 percent of renters earning $40,000 to $100,000 have used payday loans, compared with 6 percent of homeowners earning $15,000 up to $40,000.

2 Why Do Borrowers Use Payday Loans? Most borrowers use payday loans to cover ordinary living expenses over the course of months, not unexpected emergencies over the course of weeks. The average borrower is indebted about five months of the year.

Payday loans are often characterized as short-term solutions for unexpected expenses, like a car repair or emergency medical need. However, an average borrower uses eight loans lasting 18 days each, and thus has a payday loan out for five months of the year. Moreover, survey respondents from across the demographic spectrum clearly indicate that they are using the loans to deal with regular, ongoing living expenses. The first time people took out a payday loan:

- 69 percent used it to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food;
- 16 percent dealt with an unexpected expense, such as a car repair or emergency medical expense.

3 What Would Borrowers Do Without Payday Loans? If faced with a cash shortfall and payday loans were unavailable, 81 percent of borrowers say they would cut back on expenses. Many also would delay paying some bills, rely on friends and family, or sell personal possessions.

When presented with a hypothetical situation in which payday loans were unavailable, storefront borrowers would utilize a variety of other options. Eighty-one percent of those who have used a storefront payday loan would cut back on expenses such as food and clothing. Majorities also would delay paying bills, borrow from family or friends, or sell or pawn possessions. The options selected the most often are those that do not involve a financial institution. Forty-four percent report they would take a loan from a bank or credit union, and even fewer would use a credit card (37 percent) or borrow from an employer (17 percent).

4 Does Payday Lending Regulation Affect Usage? In states that enact strong legal protections, the result is a large net decrease in payday loan usage; borrowers are not driven to seek payday loans online or from other sources.

In states with the most stringent regulations, 2.9 percent of adults report payday loan usage in the past five years (including storefronts, online, or other sources). By comparison, overall payday loan usage is 6.3 percent in more moderately regulated states and 6.6 percent in states with the least regulation. Further, payday borrowing from online lenders and other sources varies only slightly among states that have payday lending stores and those that have none. In states where there are no stores, just five out of every 100 would-be borrowers choose to borrow payday loans online or from alternative sources such as employers or banks, while 95 choose not to use them.

Introduction

Deborah is a young mother who works full time as a teacher and is studying for a graduate degree. She has struggled to make ends meet. "It just seems like one thing after another," she said; "I can't seem to catch up." A few years ago, Deborah needed money when she could not afford both her monthly bills and her daughter's routine vaccinations. Deborah said that she has used student loans, bank loans, and credit cards when she was short on money. When she needed more, she thought she could get help from family or friends, but "I didn't want to ask somebody for it." Instead, Deborah borrowed a couple hundred dollars from a payday lender. "I was scared when I went in there, but I needed the money, and I knew it was a fast fix," she said. Deborah's loan was due in full on her next payday, but she could not come up with enough extra cash to pay the lump sum and meet her other expenses. So she renewed the loan, paying fees to push the due date to her next payday but receiving no reduction in the principal owed. It took nearly six months of renewals before she had enough money for a payment large enough to eliminate her payday loan debt. "Once my taxes came in, I just paid it off and walked away," said Deborah. "I was like 'I'm done.'"[4]

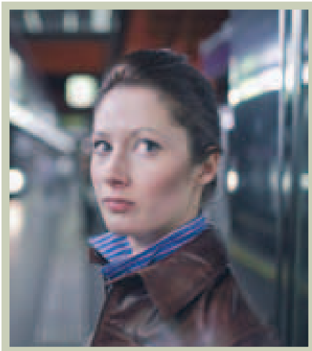
Like Deborah, a former payday loan borrower in one of Pew's focus groups, millions have turned to payday lenders when finances are tight, finding fast relief but struggling for months to repay loans that, according to marketing, are supposed to last only weeks. Payday loans are small-dollar credit products that typically range from $100 to $500, though may be larger depending on state law; the average loan is about $375.[5] Lenders usually charge about $15 per $100 borrowed per two weeks (391 percent Annual Percentage Rate or APR).[6] The loans are secured by a claim to the borrower's bank account with a post-dated check or electronic debit authorization.

Payday loans are due in full on the borrower's next payday; yet if the borrower cannot pay off the full loan plus interest, she pays a fee to extend the due date, or pays back the loan but quickly takes out a new one to cover other expenses. The loans do not amortize, so this payment does not reduce the loan principal owed. For example, a person who borrows $400 for a $60 fee for two weeks would have paid approximately $480 in fees after renewing the loan for four months, but would still owe the original $400. Most payday loans come from storefront providers with specialized state lending licenses, but similar types of small-dollar loan products are available elsewhere, including from online lenders and banks that offer “deposit advance” loans.[7]

Existing data show there are two clear problems in this market. First, payday loans are sold as two-week credit products that provide fast cash for emergencies in exchange for a fee. But the lump-sum repayment model appears to make it difficult for borrowers to avoid renewal. Pew’s analysis of state and industry data indicates that borrowers are indebted for an average of about five months of the year.[8] According to one study, 76 percent of these loans, including renewals, are borrowed within two weeks following an existing payday loan’s due date, meaning the borrower could not pay back the loan and make it to the next payday without another loan.[9] In addition, Pew’s analysis of data from Oklahoma finds that more borrowers use at least 17 loans in a year than use just one.[10]

Second, the conventional[11] payday loan business model depends upon heavy usage—often, renewals by borrowers who are unable to repay upon their next payday—for its profitability.[12] Researchers at the Federal Reserve Bank of Kansas City concluded that, “the profitability of payday lenders depends on repeat borrowing.”[13] According to industry analysts, “In a state with a $15 per $100 rate, an operator … will need a new customer to take out 4 to 5 loans before that customer becomes profitable.”[14] For example, an analysis of North Carolina data found that 73 percent of lender revenue came from borrowers using seven or more loans per year.[15] Despite these realities, payday loans continue to be packaged as short-term or temporary products.

Pew’s research seeks to explore these discrepancies between packaging and reality, and to demonstrate borrower experiences and outcomes. The survey discussed in this report is a first-ever nationally representative telephone poll of payday loan borrowers about their usage, conducted in two parts. Demographic data derive from 33,576 responses, representative of all adult Americans, while information about why borrowers used payday loans and what alternatives they have come from 451 interviews representative of all storefront payday loan borrowers.



PROFILE

Borrower A: **Female, white, married, non-parent, disabled, homeowner, high school, age 39, $28,000**

A slight majority of payday loan borrowers are female, and a slight majority of borrowers are also white. Those who are unable to work because of a disability have used a payday loan at higher rates than those who are employed, unemployed, homemakers, students, or retired.

1 Who Uses Payday Loans?

Twelve million American adults use payday loans annually. On average, a borrower takes out eight loans of $375 each per year and spends $520 on interest.

The Pew survey found that 5.5 percent[16] of American adults report having used a payday loan in the past five years.[17] In addition, using the most recent available data,[18] we calculate approximately 12 million[19] Americans used a storefront or online payday loan in 2010, a figure that is consistent with the 5.5 percent finding.

Although Pew's survey reveals that borrowing is concentrated among younger, low-to-moderate-income individuals, people of most ages and incomes use payday loans. Importantly, while these findings indicate which individuals are most likely to borrow, they do not imply that a given characteristic *causes* people to use payday loans.

Pew's survey found that borrowers are 52 percent women and 55 percent white; 58 percent rent their homes; 85 percent do not have a four-year college degree; 72 percent have a household income of less than $40,000; and 52 percent fall in the 25 to 44 age category. (See Appendix A for a complete demographic breakdown of payday loan borrowers.) However, these figures do not necessarily reflect the likelihood of payday loan usage among different demographic groups. For example, while slightly more women use payday loans than men, gender is not a significant predictor of payday loan usage. Similarly, like the general population, most payday loan borrowers are white, but white respondents are less likely to have used a payday loan than people of other races or ethnicities. The results presented in this section are largely consistent with prior research.[20]

WHAT DO BORROWERS SPEND?

Lenders sell payday loans as a temporary bridge to the next payday, though in reality most borrowers are indebted for much longer than one pay cycle. Payday loan consumers take out an average of eight payday loans a year,[21] often renewing an existing loan or taking out a new loan within days of repaying the previous one. Data from Florida indicate that borrowers who take at least 12 loans in a year use 63 percent of all payday loans.[22] The average loan is about $375.[23] Three-quarters of payday loans come from storefronts, with an average fee of $55 per loan, and roughly one-quarter originate online, with an average fee of $95. Using these figures, we calculate that the average borrower spends about $520 on interest each year.[24]

How much borrowers spend on loans depends heavily on the fees permitted by their state. The same $500 storefront loan would generally cost about $55 in Florida, $75 in Nebraska, $87.50 in Alabama, and $100 in Texas, even if it were provided by the same national company in all of those states. Previous research has found that lenders tend to charge the maximum permitted in a state.[25]

For an analysis of how borrowers in each demographic group obtain their loans (i.e., from storefronts versus online), see Exhibit 13 on page 28. For more information on the findings regarding these groups, see our website at www.pewtrusts.org/small-loans.

Which demographic traits best predict loan usage, after controlling for other factors?

Pew researchers developed a logistic regression model to evaluate how certain characteristics relate to usage, while controlling for other factors. Among these characteristics, the odds of payday loan usage are:

57 percent higher for renters than for homeowners;

62 percent higher for those earning less than $40,000 annually than for those earning more;

82 percent higher for those with some college education or less than for those with a four-year degree or more;

103 percent higher for those who are separated or divorced than for those of all other marital statuses (single, living with a partner, married, or widowed); and

105 percent higher for African Americans than for other races/ethnicities.

For more on the model and the characteristics tested, see Appendix B.

EXHIBIT 1:

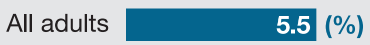
PAYDAY LOAN USAGE BY DEMOGRAPHIC

Percentage of Each Subgroup Reporting Payday Loan Usage

Certain demographic groups are more likely than others to have used a payday loan in the past five years.

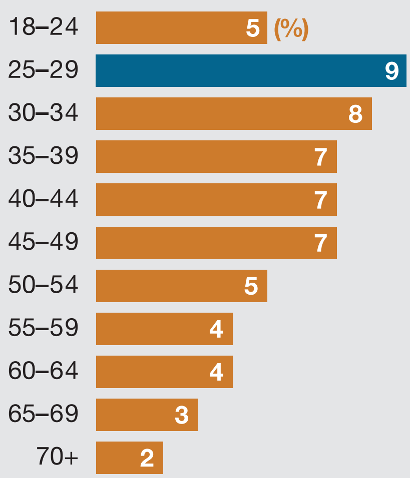
OVERALL

5.5 percent of all adult Americans have used a payday loan.



AGE

9 percent of adults aged 25-29 have used a payday loan.



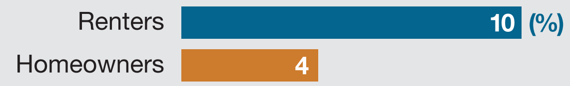
People ages 25 to 49 have used payday loans at a higher rate than the general population. By contrast, loan use is below average among 18-to-24-year-olds and those age 50 or older. There is relatively little usage by senior citizens, with just 2 percent of those 70 and older having used payday loans.

NOTE: Data represent percentage of adults in each category who report having used a payday loan in the past five years. Results are based on 33,576 interviews conducted from August through December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

RENTERS VS. HOMEOWNERS

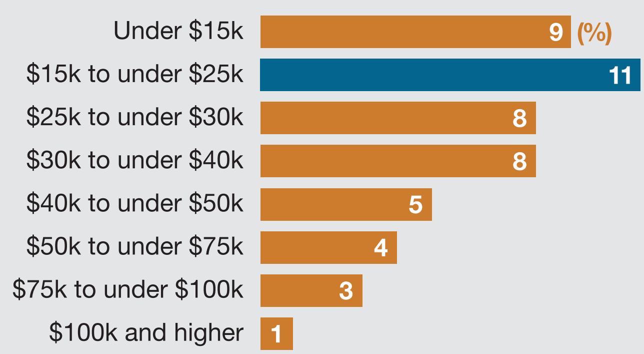
10 percent of renters have used a payday loan.



Renters have used payday loans at more than double the rate of homeowners. This sharp difference in usage between homeowners and renters persists in every age cohort. While payday loan usage is largely concentrated among those ages 25 to 49, among 50-to-69-year-old renters, fully one in 10 has used a payday loan, more than triple the rate for 50-to-69-year-old homeowners. Furthermore, renters' usage of payday loans is far higher than that of homeowners across the income distribution. For example, 8 percent of renters earning \$40,000 to \$100,000 have used payday loans, compared with 6 percent of homeowners earning \$15,000 up to \$40,000.

INCOME

11 percent of those earning \$15,000 up to \$25,000 have used a payday loan.



Respondents with household incomes less than \$40,000 are almost three times as likely to have used payday loans as respondents with household incomes of \$50,000 or more. Respondents from every income group report using payday loans, with loan usage the highest (11 percent) for those earning \$15,000 up to 25,000 and lowest (1 percent) for those earning over \$100,000. Except for those earning under \$15,000, the relationship between income and payday loan usage is an inverse one, with borrowing decreasing as income increases.

EXHIBIT 1:

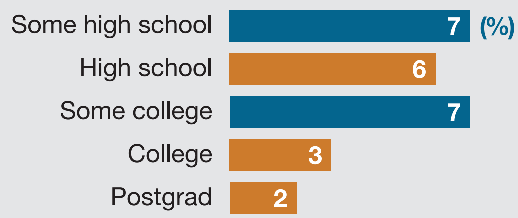
PAYDAY LOAN USAGE BY DEMOGRAPHIC

Percentage of Each Subgroup Reporting Payday Loan Usage

(CONTINUED)

EDUCATION STATUS

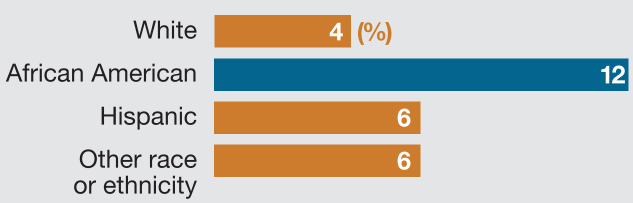
7 percent of those with some high school or some college have used a payday loan.



Those without a four-year college degree are much more likely to have used payday loans than those who have a degree. But among those without a four-year degree, further differences in education level do not correspond with significant differences in payday loan usage.

RACE AND ETHNICITY

12 percent of African Americans have used a payday loan.



African American respondents are more than twice as likely as others to have used a payday loan but make up less than a quarter of all payday borrowers, as compared with whites who comprise 55 percent of all borrowers.

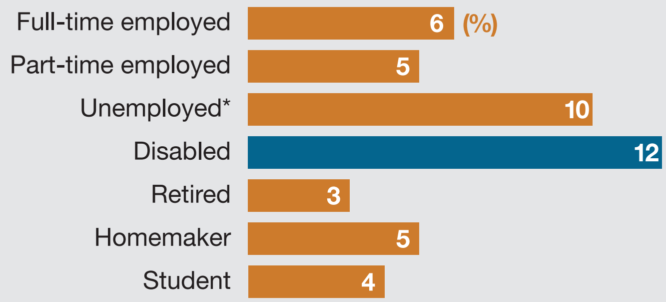
PARENTAL STATUS

8 percent of parents have used a payday loan.

Parents are more likely to have used payday loans than those who are not parents, especially among those earning less than $50,000. Twelve percent of parents earning less than $50,000 have used a payday loan, compared with just 4 percent of parents earning $50,000 or more.

EMPLOYMENT STATUS

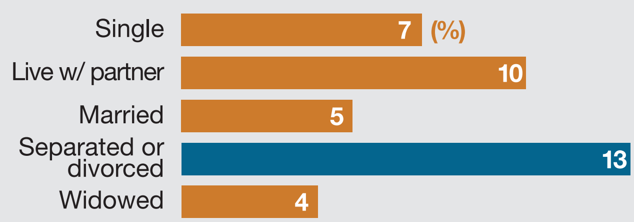
12 percent of those who are disabled have used a payday loan.



Those who are currently disabled or unemployed have used payday loans at the highest rates in the past five years, although it is possible that they were employed at the time they borrowed. However, those who are employed make up a majority of all payday borrowers, and an income stream is a requirement for obtaining a payday loan.

MARITAL STATUS

13 percent of those who are separated or divorced have used a payday loan.



Those who are separated or divorced are most likely to have borrowed. Thirteen percent of separated or divorced individuals report payday loan usage, a rate twice that of all other respondents.

*Payday lenders generally will lend only to someone with an income stream. It is possible that unemployed people were employed at the time of their last payday loan, or they are receiving a loan based on some other form of income, such as a benefits check.

NOTE: Data represent percentage of adults in each category who report having used a payday loan in the past five years. Results are based on 33,576 interviews conducted from August through December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

PAYDAY LOAN USAGE BY GEOGRAPHY

Pew's survey revealed that payday loan usage is highest in parts of the South and Midwest Census regions (e.g., 13 percent of adults have borrowed in Oklahoma and 11 percent in Missouri, two of the leading payday loan states) and is significantly higher in urban areas as compared with the suburbs. A major factor causing the significant variation in payday loan usage by Census region and division is the difference in how states regulate payday loans, detailed on page 20.

EXHIBIT 2:

PAYDAY LOAN BORROWING MORE COMMON IN CITIES

7 percent of those living in cities have used a payday loan.

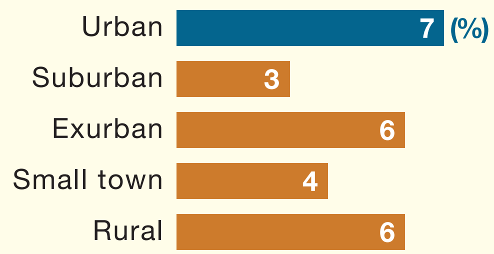
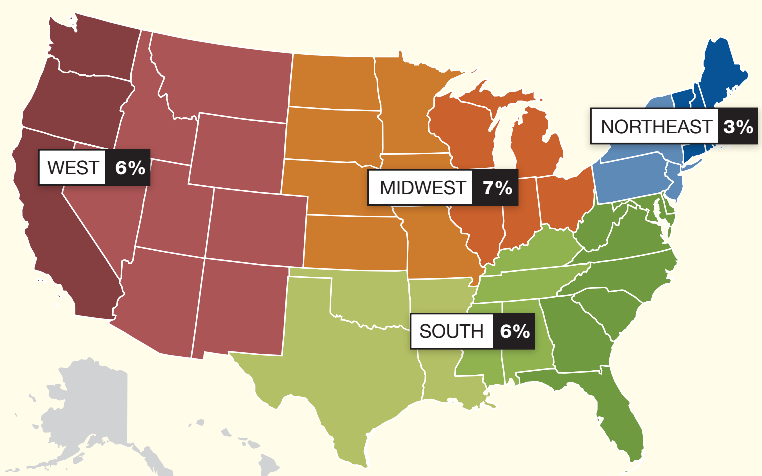
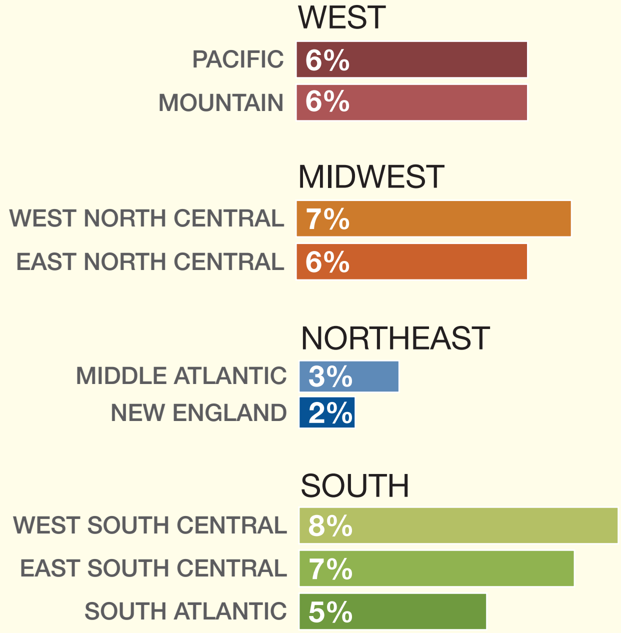


EXHIBIT 3:

PAYDAY LOAN USAGE BY GEOGRAPHIC GROUPING





NOTES: Exhibit 2: **Exurban** (Inside a Suburban County of the MSA); **Small town** (In an MSA that has no Center City); **Rural** (Not in an MSA), **Urban** (In the Center City of an MSA), **Suburban** (Outside the Center City of an MSA, but inside the county containing the Center City). The Office of Management and Budget classifies geographic areas into Metropolitan and Micropolitan Statistical Areas (MSA), and these groupings are used by the U.S. Census Bureau. The higher usage in cities is consistent with previous research demonstrating that, historically, payday lending has been tied to relatively densely populated areas, as described in Robert Mayer's *Quick Cash*. This rate is significantly higher than the 3 percent of suburban-area residents who report having used payday loans. Data represent payday loan usage by geographic area in the contiguous United States.

Exhibit 3: Regions and divisions are those used by the U.S. Census Bureau. Data represent payday loan usage by geographic area in the contiguous United States. For state-level data, see www.pewtrusts.org/small-loans.

No surveys were conducted in AK and HI.

Results from Exhibits 3 and 4 are based on 33,576 interviews conducted from August to December 2011.

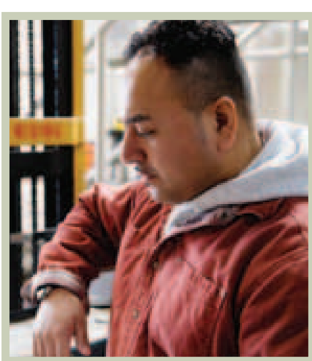
SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

2 Why Do Borrowers Use Payday Loans?

Most borrowers use payday loans to cover ordinary living expenses over the course of months, not unexpected emergencies over the course of weeks. The average borrower is indebted about five months of the year.

Pew's survey asked borrowers why they first took out a payday loan. As illustrated in Exhibit 4, borrowers' initial reasons stem from an ongoing need for income, rather than a short-term need to cover an unexpected expense.[26] Four times more storefront borrowers used their first payday loans for a recurring expense (69 percent) than for an unexpected expense (16 percent).

These findings provide a sharp contrast with the conventional image of payday loans, which are advertised as short-term, small-dollar credit intended for emergency or special use. Industry, advocates, and regulators all suggest that using payday loans for recurring expenses is not an effective use of high-cost credit and that, rather, such credit should be used to cover unexpected expenses for a short period of time.[27] Yet, previous research, as well as discussions with industry leaders, and state-level reports, all make clear that a typical borrower uses payday loans many times per year,[28] and much of this borrowing comes in relatively quick succession once someone begins using payday loans.[29] Pew's analysis of existing data found that an average borrower is in payday loan debt for five months per year, using eight loans that last 18 days each.[30]



PROFILE

Borrower B: **Male, Hispanic, divorced, non-parent, full-time employed, renter, associate's degree, age 44, $17,000**

Divorced or separated men are more likely to have used a payday loan than their female counterparts. Renters are three times more likely to have used a payday loan than homeowners, while those earning $15,000-$25,000 are the most likely to have used a payday loan.

Regular, Ongoing Expenses

Female borrower, Chicago:
"I was behind on my mortgage and cable bill."

Male borrower, Chicago:
"Just need to get to the next paycheck. And I need, you know, either pay the bill to keep the lights on, or need some food, or whatever it is."

Female borrower, San Francisco:
"If I have bills to pay, or say I need food on the table, I am going."

Male borrower, San Francisco:
"Well, I was a little short and was thinking I could use some more money and I was at the ATM actually, and it was there, offering me a direct deposit advance. So, I thought I would try it."

Unexpected Emergency/Expense

Male borrower, New York:
"I got mine because my son got in a car accident."

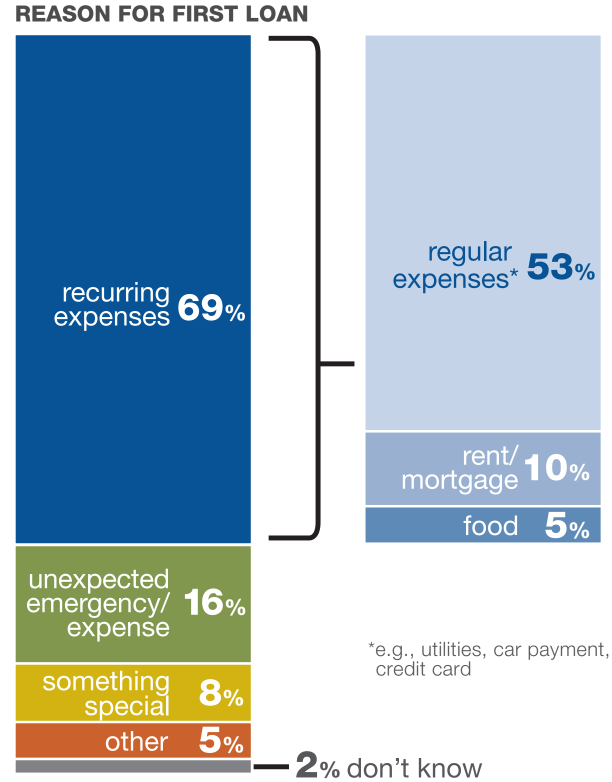
Male borrower, New York:
"I had to get money for my car to get fixed."

Something Special

Female borrower, San Francisco:
"It was the holidays and I just needed some extra cash to get gifts and help out with Christmas dinner and do my part."

Male borrower, San Francisco:
"It was a frivolous expense. Some friends wanted us to accompany them on an out-of-town trip… and I thought, 'why not?'"

EXHIBIT 4:
MOST BORROWERS USE PAYDAY LOANS FOR RECURRING EXPENSES



NOTES: Data represent percentage of borrowers who reported the reason for using their first payday loan based on 451 interviews. December 2011 - March 2012. Sampling error for the full-length survey of storefront payday loan borrowers is +/- 4.6 percentage points.

Survey participants were asked: Thinking back now to (that FIRST/the) time you took out a (online payday loan/payday loan/auto title loan), which of the following best describes what specifically you needed the money for?

1 To pay rent or a mortgage
2 To pay for food and groceries
3 To pay a regular expense, such as utilities, car payment, credit card bill, or prescription drugs
4 To pay an unexpected expense, such as a car repair or emergency medical expense
5 To pay for something special, such as a vacation, entertainment, or gifts
6 (Do not read) Other (specify)

The combined results for "Recurring Expenses" include Regular Expense (53 percent), Rent or Mortgage (10 percent), and Food (5 percent) and add to 69 rather than the expected 68 because of rounding decimals. The response options were randomized in this and other survey questions, so the order in which the respondent heard them varied to eliminate order bias.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

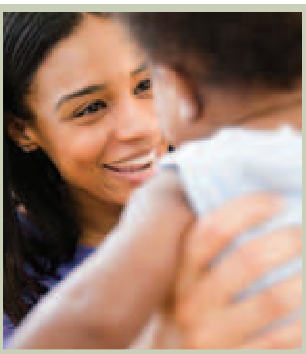
PAYDAY LOAN MARKETING VS. PRACTICE

Payday loans are frequently described as short-term credit for unexpected expenses, and marketing materials sometimes inform borrowers that payday loans are not intended for long-term use.[31] The industry advertises this small-dollar form of credit as a product that offers borrowers "access to a financial option intended to cover small, often unexpected, expenses," but states that a payday loan "is not meant to be a long-term solution."[32] A large payday lender warns in its direct mail advertisements: "Short-term loans are not intended to be long-term financial solutions."[33] Another warns: "Payday advances should be used for short-term financial needs only, not as a long-term financial solution."[34]

Despite these warnings, repeat borrowing is the norm. Prior research indicates that borrowers are indebted for an average of five to seven months of the year.[35] As a report by the Federal Reserve Bank of Kansas City Economic Research Department concluded, "The profitability of payday lenders depends on repeat borrowing."[36]

The dependence on repeat borrowing is illustrated by the reaction of payday lenders to a recent Washington State law limiting borrowers to eight loans per year. The largest storefront lender in the United States "decided to close an additional 30 centers in the State of Washington where changes in the law there have greatly affected our ability to operate profitably in that state."[37] Similarly, according to industry analysts, "In a state with a $15 per $100 rate, an operator … will need a new customer to take out 4 to 5 loans before that customer becomes profitable."[38]

The industry's stated best practices include limiting rollovers to four per person (or the state maximum) and providing extended repayment plans to borrowers who are unable to repay their loan within the original term.[39] Despite the promotion of these standards, marketing practices differ greatly. One key area of inconsistency is the practice among lenders of offering incentives to encourage habitual loan usage, such as discounts for repeat borrowing and referral bonuses.[40] As an example, one of the largest online payday lenders, which is affiliated with the largest storefront lender, offers a "Preferred Member Bonus" (Silver Status after five payday loans, Gold Status after 10 payday loans, and Platinum Status after 15 payday loans).[41]



PROFILE

Borrower C: **Female, African American, married, parent, part-time employed, renter, some college, age 28, $32,000**

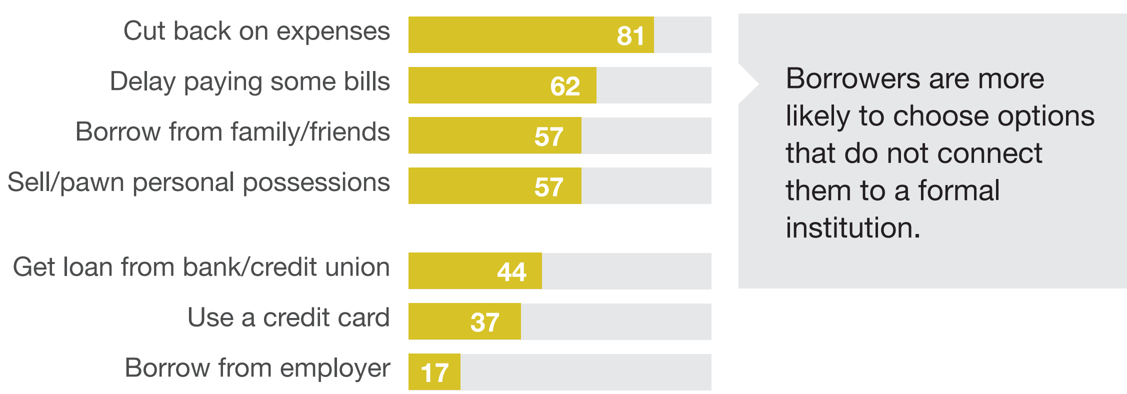
African Americans are more likely than people of other races to have used a payday loan. People ages 25-29 are more likely to have used payday loans than those in any other age group. Parents are much more likely than non-parents to have used a payday loan, regardless of marital status.

3 What Would Borrowers Do Without Payday Loans?

If faced with a cash shortfall and payday loans were unavailable, 81 percent of borrowers say they would cut back on expenses. Many also would delay paying some bills, rely on friends and family, or sell personal possessions.

Even though most borrowers use payday loans for recurring expenses, rather than for emergencies, survey respondents indicated they would use a variety of options to deal with those needs if payday loans were no longer available. In general, borrowers are more likely to choose options—such as adjusting their budgets, delaying bills, selling or pawning personal items, or borrowing from family or friends—that do not connect them to a formal institution. Eighty-one percent of payday borrowers say they would cut back on expenses if payday loans were unavailable.

EXHIBIT 5:
ALTERNATIVES IF PAYDAY LOANS WERE UNAVAILABLE



NOTES: Data represent percentage of borrowers who would use each of these strategies if payday loans were unavailable, based on 451 interviews, December 2011 to March 2012.

Survey participants were asked: "I'm going to read you several options. For each, tell me whether you would use this option if you were short on cash and short-term loans of any kind no longer existed. How about (method)? Would you use this option or not?" The "borrow from employer" item was only asked of employed respondents.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

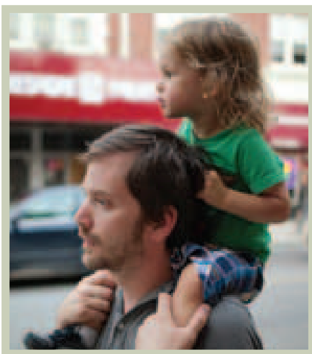
These survey findings are consistent with tactics described by former payday loan borrowers in a focus group Pew conducted in late 2011 near Manchester, New Hampshire, to find out what residents are doing now that there are no longer storefront payday lenders there. In that group, payday loan borrowers discussed various strategies they use in place of payday loans, such as re-budgeting, prioritizing bills, pawning or selling belongings, borrowing from family members, or, as one borrower stated, working out "payment plans with utility companies." Another borrower discussed prioritizing money: "I budget. I do my best, but the main thing that has to get paid is that mortgage . . . I pay that mortgage, I pay my car, I pay my insurance, and whatever is left over, that's what everything else gets paid with."

While a majority of surveyed borrowers said they would not take out a loan from a bank or credit union, many focus group participants throughout the country expressed that they would rather borrow from a bank or a credit union than from a payday lender if that option were available to them. The fact that a majority of survey respondents failed to list banks or credit unions as options may reflect an expectation, demonstrated among many focus group members, that they would not be approved for a loan.

Similarly, the fact that most survey respondents would not use credit cards may reflect a sentiment that those products are not available to them. Most, though not all, focus group participants nationwide indicated that they had maxed out their credit cards or believed they would not qualify. The reluctance to view credit cards as an alternative also may stem from confusion among some borrowers about whether the interest rate on a credit card is higher or lower than the interest rate on a payday loan. On several occasions, borrowers in focus groups equated the simple interest rate (e.g., 15 percent for a loan with a $15 per $100 fee for two weeks) with the Annual Percentage Rate disclosed for a credit card (which might be 15 percent on an annual basis). For example, a borrower from Alabama stated: "Because the interest on . . . some credit cards [is] 23.99 percent. So if you go charge $300, and then you don't pay that $300 off at the end of the month . . . they're going to tack that 23.99 percent on to it, so you're going to still be paying more than you would if you had to [get a payday loan]."

Previous surveys have found similar results to Pew's findings about payday loan alternatives. A study of former storefront payday loan borrowers in North Carolina found households have other ways to cope with cash shortfalls. For example, borrowers who experienced a shortfall within the previous three years chose instead to delay expenses (52 percent), use savings (44 percent), or borrow from family or friends (42 percent).[42] A study of

California payday loan borrowers found that of those who decided not to take out a payday loan explicitly because of the interest rate or fee, 47 percent chose to borrow from family or friends and 26 percent elected to wait until payday. In addition, for borrowers who were unable to obtain the full amount they needed from a payday lender, most chose to borrow the additional amount from family or friends.[43] Another survey of low- to moderate-income people in parts of Texas revealed that while 23 percent had used a payday loan, far more (60 percent) had borrowed from family or friends. Among payday loan borrowers in that study, 45 percent indicated they also borrowed from family or friends.[44]



PROFILE

Borrower D: **Male, white, separated, parent, full-time employed, renter, associate's degree, age 32, $41,000**

Separated people are far more likely to have used a payday loan than those of any other marital status. People who do not have a four-year college degree are much more likely to have used a payday loan than college graduates.

4 Does Payday Lending Regulation Affect Usage?

In states that enact strong legal protections, the result is a large net decrease in payday loan usage; borrowers are not driven to seek payday loans online or from other sources.

Modern payday loans owe their existence to efforts, mostly in the 1990s, to create custom exemptions to state laws that otherwise would prohibit such small-dollar loans or apply usury interest rate caps. Since then, the wisdom of allowing payday lending has been a hotly contested issue among state policy makers and stakeholders. States have deployed a variety of strategies designed to prohibit, control, or enable this form of small-dollar credit.

EXAMPLES OF STATE LAW TYPES

MISSOURI (PERMISSIVE)

Missouri permits single-repayment payday loans with finance charges and interest not to exceed 75 percent of the borrowed principal. The 2011 payday lending report from Missouri's Division of Finance cites a fee of $52.45 for a 14-day loan of $307.56 (444.61 percent APR).[45] Payday loans are available for up to $500.

Incidence: 9.7 percent storefront, 1.5 percent online

FLORIDA (HYBRID)

Florida permits single-repayment payday loans with fees of 10 percent of the borrowed principal, along with a $5 fee for borrower verification with a state database of payday loan users. Payday loans are available for up to $500 and each borrower may have out only one payday loan at any given time.

Incidence: 6.6 percent storefront, 0.6 percent online

GEORGIA (RESTRICTIVE)

Georgia state statute prohibits payday lending in most forms. As in other jurisdictions, many banks and credit unions are exempt from the restriction on payday lending in the state.

Incidence: 1.9 percent storefront, 0.5 percent online

In the past decade, some states—most recently including Arizona, Arkansas, Montana, and New Hampshire—have revived consumer protections and rolled back laws that authorized payday loans. These states have reimposed usury interest rate caps or discontinued payday lenders' exemptions from these usury limits. Other states have limited the number of high-cost loans or renewals that a lender may offer to an individual, in an attempt to enhance borrowers' ability to repay debts in a timely fashion.[46]

Following a thorough review, Pew identified three categories of state payday loan regulation. (See Exhibit 6 for a complete breakdown of the states. See www.pewtrusts.org/small-loans for a compilation of relevant laws by state and a short history of payday lending law.)

■ **Permissive states are the least regulated and allow initial fees of 15 percent of the borrowed principal or higher.** Most of these states have some regulations, but allow for payday loans due in full on a borrower's next payday with Annual Percentage Rates (APRs) usually in the range of 391 to 521 percent ($15 to $20 per $100 borrowed per two weeks). Payday loan storefronts are readily available to borrowers located in these states.[47] Most Americans—55 percent—live in the 28 Permissive states.

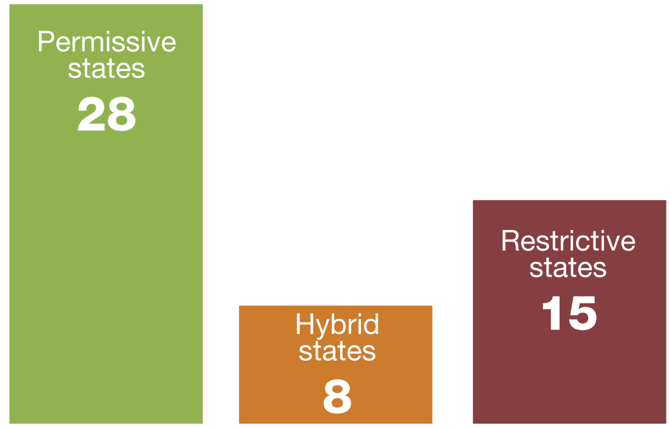
■ **Hybrid states have relatively more exacting requirements than Permissive states,** with at least one of the following three forms of regulation: (1) rate caps, usually around 10 percent of the borrowed principal, which are lower than most states but still permit loans to be issued with triple-digit APRs; (2) restrictions on the number of loans per borrower, such as a maximum of eight loans per borrower per year; or (3) allowing borrowers multiple pay periods to repay loans. Storefronts that offer payday loans exist in substantial numbers in these states,[48] though the market may be more consolidated and per-store loan volume may be higher here than in less restrictive states.[49] Sixteen percent of Americans live in the eight Hybrid states.

■ **Restrictive states either do not permit payday lending or have price caps low enough to eliminate payday lending in the state.** This rate cap often is 36 percent APR. Generally, payday loan storefronts are not found in these states. This category includes states where deferred presentment transactions (post-dated checks) are not authorized, are not specifically exempted from general state laws on usury, or are explicitly prohibited by state statute. Twenty-nine percent of Americans live in the 14 states and the District of Columbia that have a Restrictive payday loan regulatory structure.

EXHIBIT 6:

HOW STATES REGULATE PAYDAY LENDING

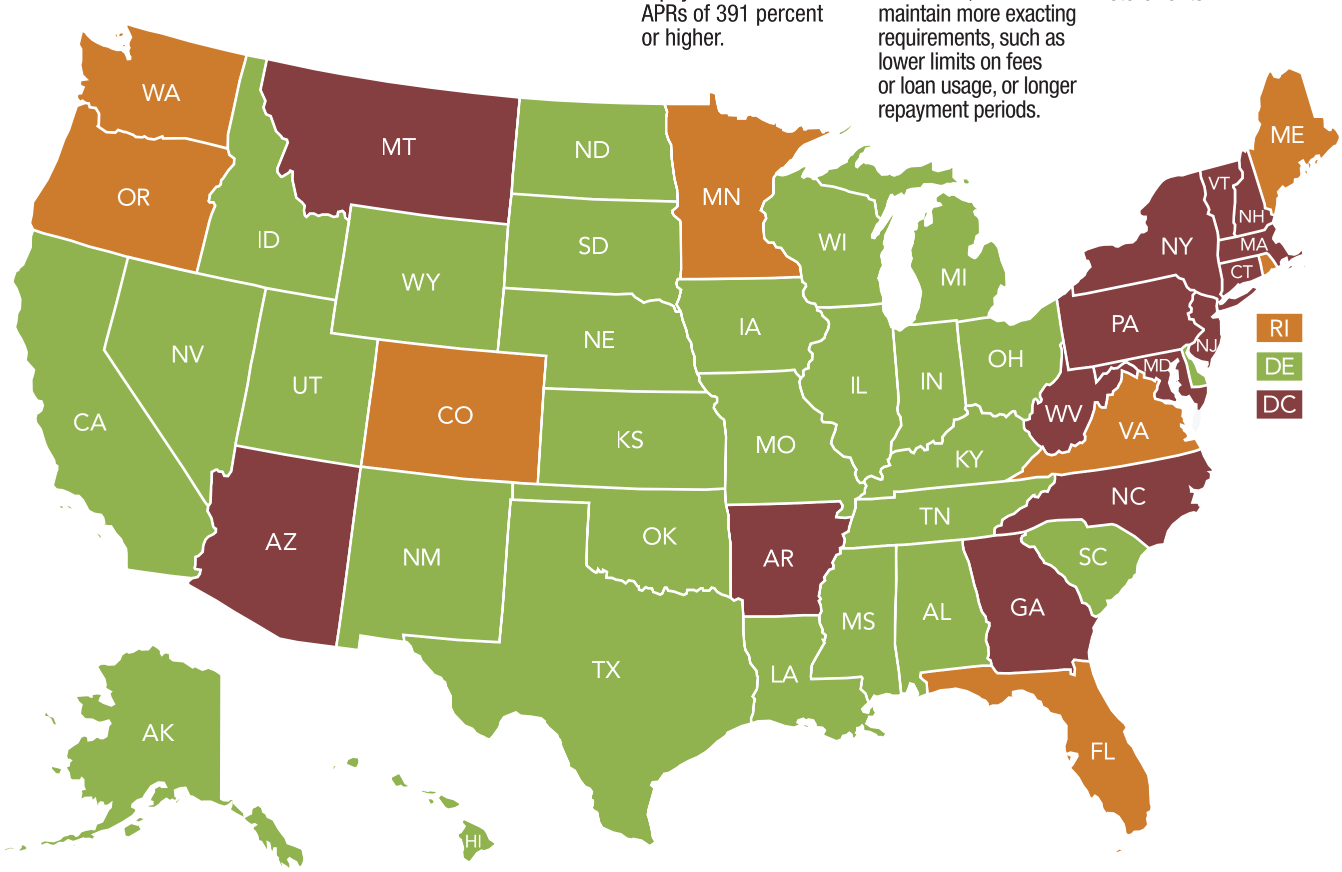
States have deployed a variety of strategies designed to prohibit, control, or enable this form of small-dollar credit.



Allow single-repayment loans with APRs of 391 percent or higher.

Have payday loan storefronts, but maintain more exacting requirements, such as lower limits on fees or loan usage, or longer repayment periods.

Have no payday loan storefronts.



SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

Payday Lending Regulation Not Leading to Increased Online Borrowing

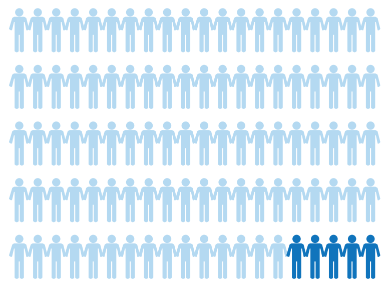
A key issue being discussed in state legislatures is whether restricting storefront payday lenders will lead borrowers to obtain loans from the Internet or other sources instead.[50] Consumer advocates[51] and some storefront lenders[52] have warned that other forms of lending, particularly online payday lending, could harm borrowers because they often occur outside the reach of state regulators. (Pew has seen evidence of fraud, abuse, and other problems with online payday lending, and will explore these later in this report series.)

However, Pew found that in Restrictive states, payday loan usage from all sources combined is far lower as compared with other states (see Exhibit 8).[53] Storefront payday loan usage is 75 percent lower in Restrictive than in Permissive states,[54] while online and other payday loan usage is only slightly higher (this difference is not statistically significant). Thus, the vast majority of would-be storefront borrowers in Restrictive states are not going online or to other providers to obtain payday loans instead.

Our data show that, in states that enact strong legal protections, the result is a large net decrease in payday loan usage (see page 23).

EXHIBIT 7:

In states that restrict storefront payday lending, 95 of 100 would-be borrowers elect not to use payday loans at all—just five borrow online or elsewhere.



SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

- Restrictive payday loan laws lead to 393 fewer storefront borrowers per 10,000 people;
- Of these, just 21 (5 percent) go online or elsewhere to get a payday loan; and
- The remaining 372 (95 percent) do not use payday loans.

In other words, in states that restrict storefront payday lending, 95 of 100 would-be borrowers elect not to use payday loans at all—just five borrow online or elsewhere.

PAYDAY BORROWING FAR LOWER IN RESTRICTIVE STATES THAN IN PERMISSIVE STATES

There is significantly less payday loan usage in states with strong legal protections because most people are not getting payday loans from the Internet or other sources instead. Although online payday lending and other sources may continue to experience substantial growth in coming years, these data give no indication that regulation of payday loan storefronts would fuel this growth. While online borrowing often is discussed as a problem in states without storefronts, it is nearly as prevalent in states with payday loan stores. In Permissive states, fully one-third of online borrowers also have borrowed from stores, choosing both methods rather than one or the other.

EXHIBIT 8:

NUMBER OF BORROWERS PER 10,000 POPULATION

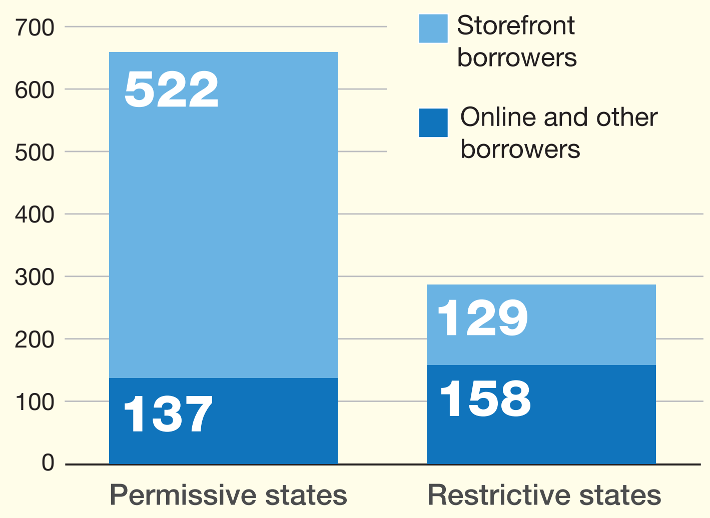


EXHIBIT 9:

METHOD OF ACQUIRING PAYDAY LOANS BY STATE LAW TYPE

Percentage of adults reporting payday loan usage in the past five years

	BORROW FROM STOREFRONT ONLY	BORROW FROM ONLINE OR OTHER*	NUMBER OF INTERVIEWS
National	4.01%	1.48%	33,576
Permissive states	5.22%	1.37%	17,881
Hybrid states	5.06%	1.28%	5,565
Restrictive states	1.29%	1.58%	10,130

NOTES: *Online or other represents all borrowers who have indicated online usage (including those who have borrowed both online *and* from a storefront), plus usage from other lenders that may include banks, credit unions, or employers, among others. Results are reported to two decimal places, but this reporting is not intended to imply such a detailed level of precision. Rather, two decimal places are used in order to avoid inaccurate calculations between groupings that could be caused by rounding. Because of sampling error, it is possible that the true level of usage in any of these groupings is slightly higher or lower.

Restrictive states are those that have no payday loan storefronts. Permissive states allow single-repayment loans with APRs of 391 percent or higher. Hybrid states have payday loan storefronts, but maintain more exacting requirements, such as lower limits on fees or loan usage, or longer repayment periods.

Data represent percentage of adults in each category who report having used a payday loan in the past five years. Results are based on 33,576 interviews conducted from August 2011 through December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

This analysis makes an evidence-based assumption backed by strong empirical data that inherent demand for payday loans is similar in Restrictive and Permissive states. Store counts from 2006 in the four states that have most recently adopted a Restrictive regulatory strategy after previously being Permissive—Arkansas, Arizona, Montana, and New Hampshire—show a similar number of stores per capita as in the other then-Permissive states: 5.5 percent fewer stores (0.64 fewer stores) per 100,000 residents in 2006 than their counterparts that remain Permissive (see Exhibit 10).[55] This fairly small difference in payday lenders per capita suggests there is not large variation between these two state groupings in demand for payday loans.[56] Other Restrictive states, such as North Carolina and Georgia, that were previously Permissive, also had heavy payday loan activity before changing their laws.[57]

EXHIBIT 10:

PAYDAY LOAN STOREFRONTS

STATE LAW TYPE	STOREFRONTS PER 100,000 RESIDENTS IN 2006
PERMISSIVE IN 2012 (WERE PERMISSIVE IN 2006)	11.57
RESTRICTIVE IN 2012 (WERE PERMISSIVE IN 2006)	10.93

NOTES: These figures are based on our analysis of state-by-state storefront data from Steven Graves and Christopher Peterson. Restrictive states are those that have no payday loan storefronts. Permissive states allow single-repayment loans with APRs of 391 percent or higher.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012; Graves and Peterson (2008).

Pew also conducted a logistic regression analysis to examine the effect of state law type on the odds of payday borrowing, controlling for borrower demographic characteristics. The findings are that the odds of payday loan usage for people who live in a Permissive or Hybrid state are 169 percent higher than for those who live in a Restrictive state, meaning a person's state of residence is a highly significant factor in predicting payday loan usage, even after controlling for borrower demographics.

To examine whether these data were considerably impacted by changes in state laws during the period of inquiry in our survey, Pew compared incidence in states that changed their laws during the past five years and those that did not.[58] There was relatively little difference in incidence of payday loan usage between states that had Restrictive regulation prior to 2007 (2.93 percent) and those five states that implemented Restrictive regulation after January 2007 (2.46 percent). Usage rates are similarly close for states with Hybrid regulation prior to 2007 (6.14 percent) and the five states that implemented Hybrid regulation in 2007 or later (6.43 percent).

Prior research has found "no evidence that prohibitions and price caps on one AFS (Alternative Financial Services) product lead consumers to use other AFS products."[59] Our research builds on that finding, revealing that the vast majority of would-be borrowers do not even substitute a new method (using the Internet instead of a storefront) to obtain the same AFS product, which in this case is a payday loan.[60]

Payday Lending Regulation Not Driving Increase in Borrower Complaints

Another issue that state legislators and regulators have considered is whether payday lending restrictions could be driving an increase in borrower complaints.[61]

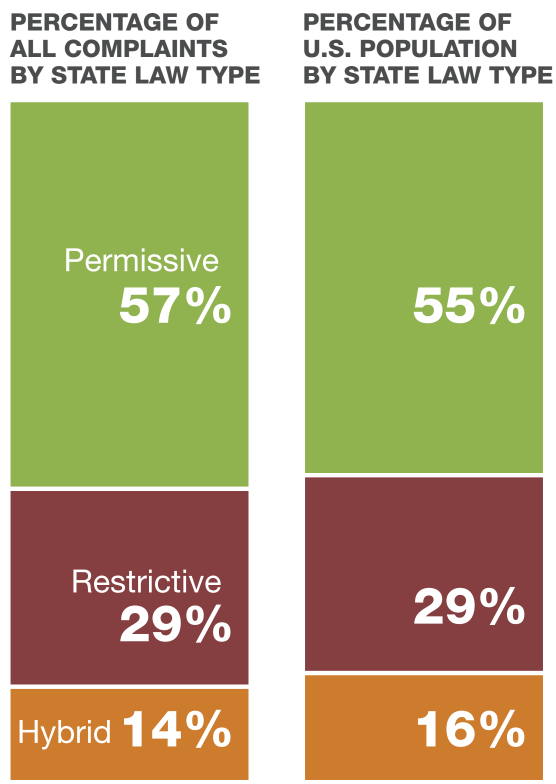
Consumer advocates also have been concerned that an increase in complaints may be driven by online lenders.[62] Given that online borrowing is nearly as prevalent in Permissive states (1.08 percent) as in Restrictive ones (1.21 percent), the rate of complaints increasing more in one type of state than another seems unlikely.

The Better Business Bureau reports that complaints against payday lenders are on the rise.[63] While online borrowing generally may indeed be driving this increase, there is no indication that the increase is attributable to efforts to regulate storefront payday lending. As shown in Exhibit 11, Pew's analysis of the complaints received by the Better Business Bureau in 2011 finds state regulations are not driving complaints against payday lenders. Twenty-nine percent of all complaints against payday lenders were filed by residents of Restrictive states, identical to the 29 percent of Americans who live in those states. Similarly, 55 percent of Americans live in Permissive states, and they filed 57 percent of complaints against payday lenders. Sixteen percent of the population lives in Hybrid states, and they filed 14 percent of payday lending complaints.

EXHIBIT 11:

STATE LAWS ARE NOT DRIVING PAYDAY LOAN COMPLAINTS

The percentage of complaints against payday lenders received by the Better Business Bureau in each state law grouping closely mirrors the percentage of the population living in those states, suggesting that regulation is not driving complaints.



NOTE: Complaints are those received by the Better Business Bureau about payday lenders in 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012; Better Business Bureau.

More evidence that complaints are not driven by consumer protections comes from Washington State, where complaints have been increasing, but the increase does not coincide with the recent change from a Permissive to a Hybrid regulatory model. Complaints increased 76 percent from 2008 to 2009, when there was no change in the law, and 50 percent from 2009 to 2010, when a change in the law took place.[64] Similarly, data Pew collected from state regulators show that from 2009 to 2011, Arkansas (Restrictive) had a 128 percent increase in complaints, Maine (Hybrid) had a 52 percent increase, and Missouri (Permissive) had a 107 percent increase.[65]

FORMER BORROWERS SPEAK ABOUT THE CHOICE BETWEEN STOREFRONT AND ONLINE

During a focus group in New Hampshire, former storefront payday loan borrowers dismissed the online option:

> "I won't leave my information there."
>
> "There's no face-to-face contact … [I]f my identity was to be stolen, well who stole it?"
>
> "It's too risky, in my opinion."
>
> "With the identity theft the way it is … who's going to see it?"
>
> "I'm not going to put [my] information out there."

Another former borrower noted that she had used online payday loans in New Hampshire when storefronts were still present, in order to pay off her storefront payday loans:

> "I had to come up with money [when] my husband was out of work, and I actually was up to $900 [in storefront payday loan debt] ... My entire check was gone the next two weeks, so that's when I went to the online ones ... And then after I did the online ones, and got in that loop, and got stuck in there, I went back to the store again, and, yeah, it got bad. And my [checking] account ended up pretty negative. I had to close it out totally."

NOTE: The focus group comprised only those people who had taken payday loans from storefronts before a recent New Hampshire law eliminated storefront payday lending.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

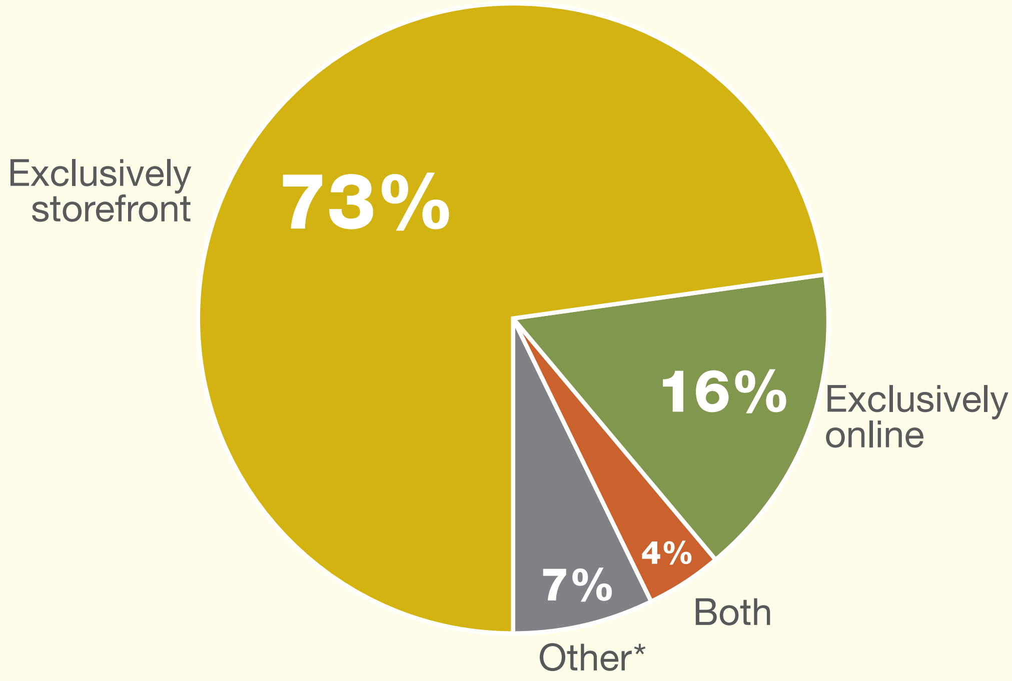
WHERE DO BORROWERS GET PAYDAY LOANS?

Pew's survey shows that retail storefronts are the exclusive source of payday loans for nearly three out of every four borrowers, while only one in six borrowers reports having used online providers exclusively (see Exhibit 12). About one in 10 borrowers has used both storefront and online providers or other types of providers, which may include banks or employers.[66]

While the overwhelming majority of borrowers use storefronts to get payday loans, certain groups are more likely than others to use online lenders (see Exhibit 13). Those who most often go online for loans tend to be younger, have incomes above $50,000, and have a college degree (for example, 41 percent of payday loan borrowers with a college degree used online lenders, and 66 percent used storefront lenders). These are the groups that use the Internet at higher rates generally throughout the population.[67]

The groups that are heavily skewed toward storefront borrowing are older, do not have a college degree, and have incomes below $50,000. White borrowers are especially likely to borrow from storefront lenders, as are disabled borrowers.

EXHIBIT 12:
HOW PEOPLE OBTAIN PAYDAY LOANS



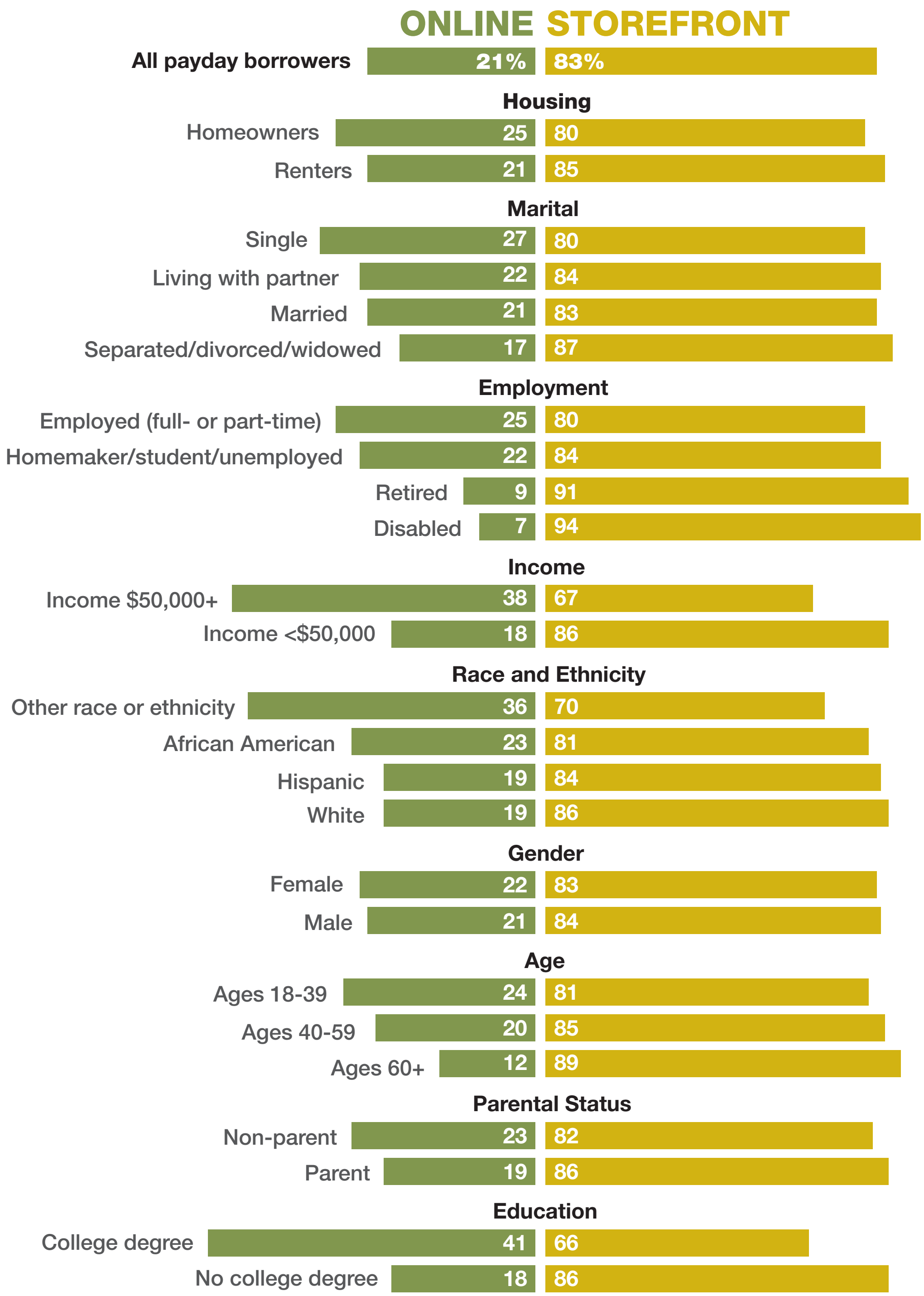
NOTES: In absolute terms, 4.0 percent of all survey respondents have used payday loans exclusively from storefronts, 0.9 percent have used payday loans exclusively from the Internet, 0.2 percent have used payday loans from both storefront locations and the Internet, and 0.4 percent of respondents have used payday loans that were neither storefront-based nor Internet-based. *Other sources may include banks, credit unions, or employers, among others.

Data represent percentage of payday borrowers who have used this type of provider in the past five years. Results are based on 33,576 interviews conducted from August 2011 through December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

EXHIBIT 13:

METHOD OF ACQUIRING PAYDAY LOANS BY BORROWER DEMOGRAPHIC GROUP



NOTES: Numbers add to greater than 100 percent because of borrowers who have borrowed both from a storefront and online; they are counted in both columns and exist in greater numbers in some subgroups. The 7 percent of borrowers who have taken a payday loan from another source, such as a bank or employer, are excluded from this section, as are the 1 percent of borrowers who declined to state which method of borrowing they utilized. Results represent the percentage of payday loan borrowers in each category who report having used the specified type of payday loan in the past five years. Results are based on 33,576 interviews conducted from August through December 2011.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

Conclusion

Payday loans are marketed as short-term credit products intended for emergency use, and they usually are depicted as a fix for an unexpected expense. However, Pew's first-of-its-kind survey reveals that seven in 10 borrowers use payday loans to deal with recurring expenses, while only one in six uses the loans for unexpected emergencies. Pew's analysis shows that the vast majority of borrowers use the loans on a long-term basis, not a temporary one. Thus it seems that the payday loan industry is selling a product that few people use as designed and that imposes debt that is consistently more costly and longer lasting than advertised. This circumstance is especially troubling because the conventional payday loan business model fundamentally relies on repeat usage—often, renewals by borrowers who are unable to repay the full loan amount upon their next payday—for its profitability.

Pew's research shows that certain demographic groups are more likely to use payday loans, including those without a four-year college degree; African Americans; those who rent rather than own a home; people earning below $40,000 annually; and those who are separated or divorced. However, it also clearly demonstrates that the payday loan is a product that crosses lines of gender, race and ethnicity, income, and education, touching most segments of society.

These findings raise serious concerns about payday lending, including whether a two-week product with an APR typically around 400 percent is a viable solution for people dealing with a chronic cash shortage.

To date, payday loans have been regulated primarily at the state level. Pew's findings show that states that have chosen to implement statutory controls on these products have been successful in realizing policy makers' goal of curbing payday lending, with 95 out of 100 would-be borrowers electing not to use payday loans rather than going online or finding payday loans elsewhere. These findings are particularly important as policy makers discuss what happens to payday borrowers when storefront lenders are not present because of regulatory action.

Moving forward, the recently created Consumer Financial Protection Bureau has the authority to regulate the payday loan market at the federal level. With this ongoing series, *Payday Lending in America*, and other research, Pew will present in-depth findings to help identify the features of a safe and transparent marketplace for such consumer financial services, to inform efforts to protect consumers from harmful practices, and to promote safe and transparent small-dollar credit.

Methodology: Opinion Research

Findings in this report are based on a screening survey to measure incidence and identify payday loan borrowers, a full-length survey of people who answered that they had used a storefront payday loan in the past five years, and a series of 10 focus groups with small-loan borrowers, as described below.

Survey Methodology

Social Science Research Solutions (SSRS) Omnibus Survey

The Pew Safe Small-Dollar Loans Research Project contracted with SSRS to conduct the first-ever nationally representative in-depth telephone survey with payday loan borrowers about their loan usage. To identify and survey a low-incidence population such as payday loan borrowers, SSRS screened 1,000 to 2,000 adults per week on its regular omnibus survey, using random-digit-dialing (RDD) methodology, from August 2011 to April 2012. The term "omnibus" refers to a survey that includes questions on a variety of topics. This survey likely minimized payday loan borrowers' denying their usage of this product, because the omnibus survey included mostly non-financial questions purchased by other clients, and the payday loan questions were asked after other, less sensitive questions, giving interviewers a chance to establish a rapport with respondents.

If during the months of August through mid-December, respondents answered that they had used a payday loan, they were placed in a file to be recontacted later. Once the full-length survey was ready to field, in order to maximize participation, people who had used a payday loan were then given the full-length survey and paid an incentive of $20 for participating. Because of their relative scarcity, online payday loan borrowers were given an incentive of $35 for participating. Respondents were told about the compensation only after having indicated that they had used a payday loan. Further, online payday loan borrowers identified during the early months of screening were sent a letter with a five-dollar bill informing them that they would be recontacted to take the full-length survey. The second phase of the research involved recontacting all respondents who answered that they had used a payday loan, and immediately giving the full-length survey to anyone newly identified in the weekly omnibus survey as a payday loan borrower.

Sample and Interviewing

In the first phase of the survey, The Pew Safe Small-Dollar Loans Research Project purchased time on Social Science Research Solutions' omnibus survey, *EXCEL*, that covers the continental United States. Analysis of the incidence was conducted after 33,576 adults had been screened and answered a question about payday loan usage.

Sampling error for the omnibus survey of borrowers is +/- 0.24 percentage points. In the second phase, another 16,108 adults were screened in order to find a sufficient number of storefront payday loan, online payday loans, and auto title loan borrowers to complete a 20-minute survey about their usage and views. A total of 451 adults completed the full-length storefront payday loan survey, and two questions from that survey were included in this publication. Sampling error for the full-length survey of storefront payday loan borrowers is +/- 4.6 percentage points. In total, 49,684 adults were screened to complete the research.

EXCEL is a national weekly, dual-frame bilingual telephone survey. Each *EXCEL* survey consists of a minimum of 1,000 interviews, of which 300 interviews are completed with respondents on their cell phones and at least 30 are conducted in Spanish, ensuring unprecedented representation on an omnibus platform. Completes are representative of the U.S. population of adults 18 and older.

EXCEL uses a fully replicated, stratified, single-stage, RDD sample of telephone households, and randomly generated cell phones. Sample telephone numbers are computer-generated and loaded into online sample files accessed directly by the Computer-Assisted Telephone Interviewing (CATI) system. Within each sample household, a single respondent is randomly selected. Further details about *EXCEL* and its weighting are available at www.pewtrusts.org/small-loans.

Question Wording—Omnibus Survey

The data from the nationally representative omnibus survey of 33,576 adults are based on responses to the following questions. Wording for demographic and other questions is available at www.pewtrusts.org/small-loans.

Screening Phase (measuring incidence and compiling sample for callbacks):

- In the past five years, have you used payday loan or cash advance services, where you borrow money to be repaid out of your next paycheck?
- And was that physically through a store, or on the Internet?

Recontact Phase (calling back respondents who answered affirmatively, and identifying additional borrowers to take the full-length survey immediately):

- In the past five years, have you or has someone in your family used an in-person payday lending store or cash advance service?

Question Wording—Full-Length Survey of Storefront Payday Loan Borrowers

The data from the nationally representative, full-length survey of 451 storefront payday loan borrowers are based on responses to the following questions, which Pew designed with assistance from SSRS and Hart Research Associates. All other questions from this survey are being held for future release. The sample for this telephone survey was derived from the RDD omnibus survey.

Thinking back now to (that FIRST/the) time you took out a (online payday loan/payday loan/auto title loan), which of the following best describes what specifically you needed the money for? (READ LIST. ACCEPT ONE RESPONSE.)

(IF MORE THAN ONE, ASK:) Well, if you had to choose just one, which best describes what specifically you needed the money for?

1 To pay rent or a mortgage

2 To pay for food and groceries

3 To pay a regular expense, such as utilities, car payment, credit card bill, or prescription drugs

4 To pay an unexpected expense, such as a car repair or emergency medical expense

5 To pay for something special, such as a vacation, entertainment, or gifts

7 (DO NOT READ) Other (SPECIFY)________________

D (DO NOT READ) Don't know

R (DO NOT READ) Refused

I'm going to read you several options. For each, tell me whether you would use this option if you were short on cash and short-term loans of any kind no longer existed. How about (INSERT)?

a. Borrow from family or friends

b. Borrow from your employer

c. Sell or pawn personal possessions

d. Delay paying some bills

e. Cut back on expenses such as food and clothing

f. Take out a loan from a bank or credit union

g. Use a credit card

Would you use this option or not?

1 Yes, would use

2 No, would not use

D (DO NOT READ) Don't know

R (DO NOT READ) Refused

Focus Group Methodology

On behalf of the Safe Small-Dollar Loans Research Project, Hart Research Associates and Public Opinion Strategies conducted eight two-hour focus groups, with two groups per location in New York City, New York; Chicago, Illinois; Birmingham, Alabama; and Manchester, New Hampshire. Those groups were conducted during weekday evenings from September 7, 2011 through September 19, 2011. The Safe Small-Dollar Loans Research Project conducted two additional groups in San Francisco, California, on November 16, 2011. All quotations come from these 10 focus groups.

EXHIBIT 14:

PAYDAY LOAN BORROWER DEMOGRAPHIC SNAPSHOT

Demographic	Percentage of All Payday Borrowers	Percentage of All American Adults
Renters	58	35
Homeowners	41	65
Single	24	31
Living with partner	14	N/A*
Married	33	50
Separated/divorced	25	13
Widowed	4	6
Full-time employed	49	59**
Part-time employed	13	
Unemployed	14	6
Disabled	8	N/A*
Retired	8	23
Homemaker	5	6
Student	3	5
Income <$15,000	25	13
Income $15,000 to under $25,000	24	11
Income $25,000 to under $30,000	11	
Income $30,000 to under $40,000	13	25**
Income $40,000 to under $50,000	8	
Income $50,000 to under $75,000	10	19
Income $75,000 to under $100,000	5	12
Income $100,000+	1	21
White (non-Hispanic)	55	64
African American (non-Hispanic)	23	12
Hispanic	14	16
Other race/ethnicity	6	8
Ages 18-24	12	13
Ages 25-29	16	9
Ages 30-34	12	9
Ages 35-39	11	9
Ages 40-44	13	9
Ages 45-49	11	10
Ages 50-54	10	10
Ages 55-59	5	8
Ages 60-64	5	7
Ages 65-69	3	5
Ages 70+	3	12
Parent	38	30
Non-parent	62	70
<High school	16	15
High school	38	29
Some college	31	30
College	11	16
Postgrad	3	9
Male	48	49
Female	52	51

This table describes the demographic characteristics of payday loan users overall, based on responses to Pew's survey. For example, 58 percent of all payday loan users rent (as opposed to own) their homes. For more on the survey, see the Methodology.

NOTES: All payday borrower data come from payday borrowers identified through 33,576 interviews conducted from August through December 2011 on behalf of Pew's Safe Small-Dollar Loans Research Project.

All comparative data except for employment status come from the Census Bureau's 2010 Decennial Census, the 2006–2010 American Community Survey 5-Year Estimates, and the 2008–2010 American Community Survey 3-Year Estimates. Employment status data come from a three-month average (March, April, and May 2012) of the NBC News/*Wall Street Journal* Survey, a nationally representative monthly telephone survey.

Data may not equal 100 percent due to rounding or because respondents declined to answer.

Marital status is based on residents 15 years of age and older. Educational attainment is based on adults 25 to 64 years of age. Other data, including Pew's survey data, represent adults 18 years of age and older.

*N/A Certain data were unavailable and/or are not comparable to Pew's survey.

**The Census uses slightly different income and employment categories in its survey.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012; U.S. Census Bureau; NBC News/*Wall Street Journal* Survey.

Modeling the Likelihood of Borrowing by Demographics

To test the relationship between specific demographics and payday loan usage, Pew developed a statistical model to analyze the predictive strength of each demographic while holding all others constant. For example, the model tests whether there is a strong relationship between renting a home and borrowing a payday loan, regardless of a borrower's other characteristics such as income. The following eight demographics were examined and compared with those people who were not in the selected category (e.g., those who have annual household incomes below $40,000 are compared with those who have annual household incomes of $40,000 or higher).

- Ages 25 to 34
- Annual household income below $40,000
- Parents (with minor, financially dependent children)
- Some college education or less
- Renters
- African Americans
- Females
- Marital status is separated or divorced

It is important to reiterate that a limitation of our analysis is the time frame. While the survey recorded current demographics, payday loan borrowers were asked about loans they had taken out in the past five years. We are not implying any causality, and it would be incorrect to assume that certain characteristics are necessarily causing an increase in payday loan usage. Rather, the findings show strong relationships between certain characteristics and payday loan usage, many of which previous studies also have identified.[68]

In interpreting the logistic regression, the analysis focuses especially on the odds ratio, which shows the likelihood of payday loan usage based on the presence of a particular characteristic.

All relationships are significant at the 99 percent confidence level, with the exception of gender. This is not a surprising finding, as differences between males and females in Pew's initial analysis were slight and sometimes decreased when other variables were introduced. Thus, it is likely that the initial difference in usage by gender is being caused by other characteristics that correlate with gender, such as parental status or income.

Again, the baseline for payday loan usage is 5.5 percent across all adults. The figures resulting from this analysis describe only how much more likely it is that one type of person is to have used payday loans relative to another.

EXHIBIT 15:

LOGISTIC REGRESSION ANALYSIS OF LIKELIHOOD OF PAYDAY LOAN USAGE BY SELECT DEMOGRAPHICS

The percentages described in the body of the report as coming from a logistic regression model are derived from the Odds Ratio, and are calculated by subtracting 1 from the Odds Ratio. Thus, those who are Separated or Divorced, with an Odds Ratio of 2.034, are 103.4 percent more likely to have used a payday loan.

	Coefficient ß	S.E. ß	Wald's X^2	Odds Ratio
AfAm	0.717***	0.073	95.322	2.048
SepDiv	0.71***	0.072	96.729	2.034
NonCollege	0.6***	0.088	46.295	1.823
Income<$40k	0.479***	0.071	45.167	1.615
Rent	0.452***	0.066	47.118	1.572
Parent	0.352***	0.065	29.246	1.422
Age25to34	0.349***	0.071	23.786	1.417
Female	-0.122**	0.062	3.928	0.885
Constant	-3.94	0.093	1781.417	0.019

NOTE: * p<.10, ** p <.05, and *** p<.01.

SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

Endnotes

1 David Burtzlaff and Brittny Groce. "Payday Loan Industry," (2011). Stephens Inc.

2 Marketers of payday loans routinely characterize the products as short-term solutions that are not meant to be used for long periods of time. For example, the Financial Service Centers of America (FiSCA), an industry trade group, describes a payday advance as a "short-term loan to cover expenses between paydays." "FiSCA Consumer Financial Services Factsheet," available at http://www.fisca.org/Content/NavigationMenu/ConsumerCenter/ConsumerFactSheet/CONSUMERCENTER-ConsumerFactSheet_Final_withlogo.pdf (accessed March 30, 2012).

3 Pew's research shows that the vast majority of borrowers report obtaining their loans from retail storefronts, which are non-bank, state-licensed entities that specialize in this form of lending. However, payday and similar types of loans are available online and from a growing number of banks. A small number of national and regional banks have developed small-dollar loan products that mimic or closely resemble conventional payday loans. These bank products are sometimes called "deposit advance" loans. The acting chairman of the Federal Deposit Insurance Corporation (FDIC) recently expressed "deep concern" about banks engaging in payday lending and announced an intention to investigate this trend. See FDIC letter at www.responsiblelending.org/payday-lending/policy-legislation/regulators/fdic-invests-bank-payday-lending.html.

4 In the fall of 2011, Pew contracted with research firms to hold focus groups of current and former payday loan borrowers. Participants told their stories and discussed a variety of questions related to their use of payday loans and other financial products. Deborah's story and her quotations are taken from one such focus group, which was conducted in New Hampshire (Deborah discussed experiences with storefront payday lenders that occurred prior to 2009, when New Hampshire enacted a 36 percent annual interest rate cap that effectively eliminated storefront payday lending in that state). "Deborah" is not the borrower's real name. We have used a pseudonym to protect the participant's privacy, but all other details are unaltered.

5 In 2011, the average payday loan at the nation's largest payday lender—Advance America—was $375, based on its annual report. Industry analyst Stephens Inc. uses Advance America as a proxy for the payday lending industry. Stephens Inc., "Payday Loan Industry," (2011).

6 Fees from online lenders often are higher, averaging $25 per $100 borrowed per two weeks, or 652 percent APR. Consumer Federation of America, "CFA Survey of Online Payday Loan Websites," (2011). See www.pewtrusts.org/small-loans for more information on state payday lending laws.

7 Although payday loans are not a new form of credit, the modern payday lending industry arose in the 1990s when a number of states modified their consumer lending laws, enacting special exceptions to interest rate caps and other laws that had traditionally regulated credit. See www.pewtrusts.org/small-loans for more information on the history of payday lending laws.

8 This calculation is based on a borrower using eight loans (the average number used annually according to state reports) for 18.2 days (the average duration of a payday loan, according to Advance America's annual (10-K) report). Multiplying these figures indicates an average of 146 days of indebtedness per year.

9 Leslie Parrish and Uriah King, "Phantom Demand," (Center for Responsible Lending, June 2009), http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

10 Oklahoma probably is not an outlier, as the average number of loans used by borrowers in Oklahoma per year (8.7) is similar to the average from other states, based on state reports. Calculations use data in "Oklahoma Trends in Deferred Deposit Lending, 2010," www.ok.gov/okdocc/documents/2010_10_OK%20 Trends_Final_Draft.pdf.

11 Payday and similar types of loans are available online and from a growing number of banks; however, Pew's research shows that the vast majority of borrowers report obtaining their loans from retail storefronts, which are non-bank, state-licensed entities that specialize in this form of lending.

12 A study funded by the payday lending industry found that 78 percent of borrowers take out five or more payday loans each year; Gregory Elliehausen, "An Analysis of Consumers' Use of Payday Loans," *Financial Services Research Program Monograph* No. 41, (George Washington University, 2009). Another study by consumer advocacy group Center for Responsible Lending found that Oklahoma borrowers who use payday loans take out an average of nine loans in their first year of borrowing; Uriah King and Leslie Parrish, "Payday Loans, Inc.: Short on Credit, Long on Debt," (Center for Responsible Lending, 2011). See also: "Report on the Business of Providing Deferred Presentment Service Transactions in Michigan," (2007), www.michigan.gov/documents/cis/OFIS_DPST_REPORT_204749_7.pdf; and "Florida Trends in Deferred Presentment," (2010), www.veritecs.com/Docs/2010_06_FL_Trends-UPDATED.pdf.

13 Robert DeYoung and Ronnie J. Phillips. "Payday Loan Pricing," (Federal Reserve Bank of Kansas City Economic Research Department, 2009), www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf.

14 Stephens Inc., "Payday Loan Industry," (2011).

15 Michael A. Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing," *Economic Development Quarterly* (2003), www.ccc.unc.edu/abstracts/0203_Payday.php.

16 Our 5.5 percent payday loan usage number closely mirrors the 5 percent number found by the FINRA Foundation in their telephone survey conducted in 2009; Applied Research and Consulting, "Financial Capability in the United States," prepared for the FINRA Investor Education Foundation, (2009). It is somewhat higher than the 3.5 percent of households who reported ever having used payday loans in the 2009 FDIC supplement to the Current Population Survey; "Addendum to the 2009 FDIC National Survey of Unbanked and Underbanked Households: Use of Alternative Financial Services," (2010), www.fdic.gov/householdsurvey/AFS_Addendum.pdf). The number also is higher than the 3.9 percent of households who reported having used a payday loan in the past year in the Federal Reserve Board's Survey of Consumer Finances, although that survey asked just about the past year, whereas our survey asked about the past five years; www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf. Earlier research has found and discussed evidence of known payday loan borrowers denying their usage of these loans in survey research: Gregory Elliehausen and Edward Lawrence, "Payday Advance Credit In America: An Analysis Of Customer Demand," (Monograph #35, 2001); Dean Karlan and Jonathan Zinman, "Lying About Borrowing," *Journal of the European Economic Association Papers and Proceedings* (2007); and Applied Management & Planning Group and Analytic Focus, "2007 Department of Corporations Payday Loan Study," (2008). To minimize underreporting in this survey, borrowers were asked about payday loan usage as part of an omnibus poll that covered mostly non-financial topics. In addition, the questions about payday loans were asked well into the survey, giving the interviewer a chance to establish a rapport with respondents before asking about this relatively sensitive issue.

17 The margin of error for payday loan usage in the omnibus survey is +/-0.2 percentage points. Margins of error for subgroups are included on our website at www.pewtrusts.org/small-loans.

18 We calculate the number of unique payday loan borrowers in 2010 using three different methods that all point toward roughly 12 million people having used payday loans that year. Based on our survey data, 18 percent of traditional payday loan borrowers (storefront or online, not other sources such as employers or banks) are borrowing exclusively online. All of these calculations refer to storefront data and then treat that population as 82 percent of the universe of payday loan borrowers, adding in the online-only borrowers afterwards. All of these calculations also utilize the Stephens estimate that there were 19,700 payday lending stores in the U.S. in 2010. Numbers have been rounded to avoid giving the impression that these calculations are precise, because they all involve reliance on data that are either incomplete or from a handful of states. Thus, each of these calculations is likely flawed because of data limitations, but the results cluster around, and average, 12 million borrowers.

Method 1: *Estimating transactions per store, multiplying by the number of stores, and dividing by the number of loans per borrower.*

We used the data from the 2010 published state payday loan reports that include number of transactions and number of storefronts: California, Florida, Oklahoma, and Washington. States that had reports from previous years but not reports based on 2010 data were reviewed but not included, such as Illinois, Michigan, North Dakota, and Virginia. Dividing the number of payday loan transactions by the number of payday loan stores yields 4,236 payday loans per store in 2010. Multiplying that figure by 19,700 yields 83.4 million loans. Dividing this figure by the eight loans per borrower figure, which is the average in the state reports, implies just over 10.4 million borrowers. Adding back in the 18 percent of borrowers who are borrowing only online adds to roughly 12.7 million.

Method 2: *Using the state reports to record or derive the number of unique borrowers in each state, and dividing by the number of stores in those states to create a borrowers per store ratio.* This calculation, based on the three states with published 2010 data on unique borrowers (Florida, Oklahoma, and Washington), yields a figure of approximately 486 unique borrowers per store. We then multiply that ratio by the number of stores in the country to reach roughly 9.6 million. Adding back in the 18 percent of borrowers who are borrowing only online adds to roughly 11.7 million.

Method 3: *Recording the number of unique borrowers in the reported states, dividing that figure by the adult population to determine a usage rate, and then multiplying that figure by the population in all of the states where payday loans are allowed.* Using this method gives us a usage rate of 4.8 percent in the states that publish detailed reports. Seventy-one percent of the population lives in states that have payday loan stores, while 29 percent do not. We multiply the 4.8 percent by the 163 million adults who live in states with stores, and then multiply the other 66 million adults by 1.2 percent, because our survey data show that storefront usage in restrictive states is one-fourth the level that it is in other states. This calculation suggests 8.7 million storefront borrowers, somewhat lower than the other methods. One reason for this disparity may be that most of the highest-usage states do not publish reports, so the 4.8 percent usage figure we derived may be slightly lower than the true usage figure in nonrestrictive states. Adding back in the 18 percent of borrowers who are only online would yield an estimate of 10.6 million borrowers per year.

19 This figure of 12 million borrowers is lower than some earlier estimates of payday loan usage, which may be partially explained by the fact that payday lenders have left some states because of regulations, and by high unemployment (given that a regular income stream is a prerequisite for obtaining a payday loan). Social insurance programs for individuals out of work also may provide an income stream on which a payday loan can be secured. Nonetheless, the high rate of unemployment in recent years and particularly the unprecedented rates of the unemployed who have been out of work for an extended period of time likely have a dampening effect on overall payday loan usage. The estimate of 12 million borrowers refers only to those using payday loans from storefronts or the Internet, not those using payday loans from banks, employers, or other sources.

20 Amanda Logan and Christian E. Weller, "Who Borrows from Payday Lenders?" (2009); Gregory Elliehausen, "An Analysis of Consumers' Use of Payday Loans," *Financial Services Research Program,* Monograph #41. (2009).

21 This figure is the average number of loans used based on the 2010 state reports from Florida, Oklahoma, and Washington. It also is consistent with data released by other states that either lack a database or did not publish a 2010 report, such as Michigan's 2007 data, Virginia's 2008 data, and California's data from 2006-2010.

22 "Florida Trends in Deferred Presentment," Program Status Report, (May 2010), www.veritecs.com/Docs/2010_06_FL_Trends-UPDATED.pdf.

23 In 2011, the average payday loan at the nation's largest payday lender—Advance America—was $375, based on its annual (10-K) report. Industry analyst Stephens Inc., uses Advance America as a proxy for the payday lending industry. Stephens Inc. "Payday Loan Industry," (2011).

24 This figure is based on using the average loan size ($375 in Advance America's 2011 Annual Report), the average number of times (eight—based on data in state reports) in a year. Three quarters of these are storefront loans, charging an average of $55 per loan, based on the average fee disclosed in Advance America's 2011 Annual Report, and similar fees in the other publicly traded lenders' annual reports. Roughly one-quarter are online loans, charging an average of $95 for an equivalent loan, based on the rates cited by industry analyst Stephens Inc., in its 2011 report. Six fees of $55 and two fees of $95 yield our estimate of $520 spent by each borrower. If all eight loans came from a storefront, this figure would be $440, while if all eight loans were obtained online, the figure would rise to $760. These calculations assume the borrower does not incur any extra fees. The Center for Responsible Lending has made similar calculations in its publications, finding that a typical borrower pays back $793 on a $325 loan, spending $468 on interest. This calculation was based on storefront lending and was made before online lending had expanded to its present level with higher interest rates charged. See Uriah King, Leslie Parrish, and Ozlem Tanik. "Financial Quicksand: Payday Lending Sinks Borrowers in Debt with $4.2 Billion in Predatory Fees Every Year," (November 2006), http://www.responsiblelending.org/payday-lending/research-analysis/financial-quicksand-payday-lending-sinks-borrowers-in-debt-with-4-2-billion-in-predatory-fees-every-year.html.

25 Robert DeYoung and Ronnie J. Phillips, "Payday Loan Pricing," (Federal Reserve Bank of Kansas City Economic Research Department, 2009), www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf.

26 Previous surveys also have found that a substantial percentage of borrowers use payday loans to cover regular household expenses and other nonemergency needs. A 2007 study conducted for the California Department of Corporations reports that half of borrowers (50.2 percent) selected "pay other bills" as their reason for using a payday loan (an additional 22.3 percent selected "groceries/necessary household goods"). The "pay other bills" category is separate from groceries/necessary household goods, emergency situations, car repairs, and medical services. While categories differ slightly between each survey, both surveys separate regular expenses from food/groceries, emergencies, car repairs, and other, therefore providing a comparable benchmark for usage; Applied Management Planning Group and Analytic Focus, "2007 Department of Corporations Payday Loan Study," (2008), www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf. Also, the Federal Reserve's 2010 Survey of Consumer Finances (SCF), which asks about the most recent payday loan, found 42.4 percent of borrowers indicated it was for an emergency "and similar urgent needs or a lack of other options." The difference in overall incidence (3.9 percent payday usage in the 2010 survey) between Pew's results and results from the SCF may be explained by differences in time period queried (five-year versus one-year time span). The large difference in reason for usage in the "emergency" category is likely a result of survey wording, or including "a lack of other options" in the SCF question, which makes its emergency category far broader. Pew's survey question was seeking to capture something different than the SCF, to ascertain the purpose of the loan ("emergency"), without attempting to combine that with why the borrower chose a payday loan provider ("lack of other options"). A borrower may have both a regular

expense and a lack of other options, or an emergency expense but multiple options, so we did not seek to pair the reason for a loan with the reason for choosing a payday loan provider. SCF data are available at http://www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf.

27 The industry's largest trade association, Community Financial Services Association of America (CFSA), as well as many payday loan companies, note on their websites and in advertisements that payday loans are an expensive form of credit and intended for short-term or emergency use, and not as long-term solutions. For examples, see websites for CFSA (http://cfsaa.com), QC Holdings (www.QCholdings.com), and Cash America (www.cashamerica.com/loanoptions/cashadvances.aspx). See also: Gregory Elliehausen and Edward C. Lawrence, "Payday Advance Credit in America: An Analysis of Customer Demand," (April 2001), 37, 40; and Gregory Elliehausen, "An Analysis of Consumers' Use of Payday Loans," (January 2009). "While payday loans might rarely if ever make sense for financing household investment directly, payday loans may provide rationed borrowers with a source of emergency funds that allows greater levels of debt-financed investment," as quoted from www.cfsaa.com/portals/0/RelatedContent/Attachments/GWUAnalysis_01-2009.pdf.

28 See endnote 12.

29 Parrish and King, "Phantom Demand," (2009).

30 The exact figure is 18.2 days, and comes from the 2011 Annual Report (10-K) filed with the Securities and Exchange Commission by the largest storefront payday lender, Advance America.

31 For example, the website of Check Into Cash, one of the largest payday lenders, notes that a payday loan "is not intended to be used as a long-term budget solution." Available at: http://checkintocash.com/faq/how-often-do-most-people-use-cash-advance-services/.

32 The industry's largest trade association, Community Financial Services Association of America (CFSA), provides a detailed overview of the industry and product on its website (http://cfsaa.com).

33 Quoted from Advance America direct mail piece "Your Line's Slowed. Your Bills Haven't," (2011).

34 Quoted from QC Holdings website, www.QCholdings.com.

35 These estimates vary somewhat based on the law, and especially the minimum loan term, in the state analyzed, but the most detailed analysis is the Center for Responsible Lending's finding of 212 days of indebtedness for Oklahoma borrowers in *Payday Loans, Inc.*

36 Robert DeYoung and Ronnie J. Phillips, "Payday Loan Pricing," (Federal Reserve Bank of Kansas City Economic Research Department, 2009), www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf.

37 James A. Ovenden, "Quarterly Earnings Call, Advance America," Q2, (2011), http://seekingalpha.com/article/283283-advance-america-cash-advance-centers-ceo-discusses-q2-2011-results-earnings-call-transcript.

38 Stephens Inc., "Payday Loan Industry," (2011).

39 Community Financial Services Association of America (CFSA) Member Best Practices, http://cfsaa.com/cfsa-member-best-practices.aspx.

40 California Department of Corporations "Table 7: Amount of Referral Bonus Offered," www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf.

41 Information from CashNetUSA website, www.cashnetusa.com/rewards.html.

42 UNC Center for Community Capital, "North Carolina Consumers After Payday Lending," (2007), www.ccc.unc.edu/documents/NC_After_Payday.pdf.

43 Applied Management & Planning Group and Analytic Focus, "2007 Department of Corporations Payday Loan Study," (2008), www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf.

44 Texas Appleseed, "Short-term Cash, Long-term Debt: The Impact of Unregulated Lending in Texas," (2009), www.appleseednetwork.org/Portals/0/Documents/Publications/Center%20Pubs/TX%20Payday%20Lending.pdf.

45 Missouri Division of Finance. "Report to General Assembly on Survey of Payday Lenders," (2011), http://finance.mo.gov/consumercredit/documents/2011PaydayLenderSurvey.pdf.

46 Subsequent to passing legislation authorizing payday lending, Arizona, Arkansas, the District of Columbia, Georgia, Montana, North Carolina, and New Hampshire reimposed double-digit usury caps on deferred presentment transactions, allowed the authorizing legislation to expire, or prohibited the transaction. Colorado, Florida, Maine, Minnesota, Oregon, Rhode Island, Virginia, and Washington have lowered permissible loan fees while retaining triple-digit annual percentage rates, implemented structural requirements to permit borrowers multiple pay periods to repay their loans, or limited to the single digits the number of payday loans per borrower per year. Ohio passed legislation and also passed a ballot initiative restricting interest on payday loans to 28 percent APR, but payday lending has continued with effective loan terms and APRs that often are similar to those before the law change.

47 Stephens Inc., "Payday Loan Industry," (2011).

48 Steven Graves and Christopher Peterson, "Usury Law and the Christian Right: Faith-Based Political Power and the Geography of American Payday Loan Regulation," *Catholic University Law Review*, Vol. 57, 2008: 637.

49 Robert B. Avery and Katherine A. Samolyk, "Payday Loans versus Pawn Shops: The Effects of Loan Fee Limits on Household Use," (preliminary draft, 2011).

50 For example, "House Mulls Reviving Payday Loans," *New Hampshire Business Review*, www.nhbr.com/businessnewsstatenews/935663-257/house-panel-mulls-reviving-payday-loans.html.

51 Consumer Federation of America, "CFA Survey of Online Payday Loan Websites," (2011).

52 "Analysis: U.S. Payday Lenders Point Fingers to Blunt Crackdown," *Reuters,* (January 20, 2012), www.reuters.com/article/2012/01/20/us-financial-regulation-payday-idUSTRE80I04R20120120.

53 This section includes results reported to two decimal places, but this reporting is not intended to suggest a greater level of precision. Rather, two decimal places are used in order to avoid inaccurate calculations between groupings that could be caused by rounding to one decimal place or the nearest integer. Even with these large sample sizes, there is a degree of sampling error. It is possible, therefore, that the actual number of would-be storefront borrowers who are going online is slightly lower or higher, because the results reported are based on survey research, and thus have a margin of error. These figures are fairly consistent with estimates from Stephens Inc., that roughly one-quarter of payday loan volume is online. Our survey data suggest just under one-quarter of traditional (storefront or online, but not "other") payday loan borrowers have borrowed online. Note that the 7 percent "other" finding may include products from banks or employers but should not be taken as a general estimate of bank payday or "deposit advance" lending.

54 This finding that storefront payday borrowing is lower in Restrictive states is consistent with prior research. Examples include: Applied Research & Consulting, "Financial Capability in the United States," (2009); and "Addendum to the 2009 FDIC National Survey of Unbanked and Underbanked Households: Use of Alternative Financial Services," (2010), www.fdic.gov/householdsurvey/AFS_Addendum.pdf.

55 These figures are based on our analysis of state-by-state storefront data from Graves and Peterson, "Usury Law and the Christian Right," (2008). Peterson and Graves' data were used because of the level of detail, recording individual storefronts by ZIP code. The same calculations using Stephens' 2006 data yield similar results, with 10.71 storefronts per 100,000 residents in now-Restrictive states, and 11.50 storefronts per 100,000 residents in now-Permissive states, or 6.9 percent fewer. To calculate storefronts per capita, we obtained population estimates from the 2006 American Community Survey (available at www.factfinder2.census.gov). We selected 2006 because none of these states had begun to change their regulatory structure yet, and detailed data on storefronts by state were available. Restrictive states either cap payday loan interest rates at double-digit APRs or prohibit deferred presentment transactions. Permissive states either do not cap interest rates or tend to cap them at 391 percent APR or higher, and generally allow the entire loan to be due on a borrower's next payday. Alaska and Hawaii are included in this example and in all exercises that do not rely on the survey data.

56 Similarly, there is little difference in Internet access between Restrictive and Permissive states. Data from the U.S. Census Bureau's 2012 Statistical Abstract (Table 1156) show that at least 70 percent of people in every state report having Internet access. In both the average Permissive state and average Restrictive state, exactly 80 percent of residents report having Internet access either inside or outside the home. If this calculation is limited to in-home access, in the average Restrictive state 72 percent of residents have Internet access, compared with 71 percent in the average Permissive state. Data available at www.census.gov/compendia/statab/cats/information_communications/internet_publishing_and_broadcasting_and_internet_usage.html.

57 For example, the North Carolina Commissioner of Banks report using 1999 data notes more than 2.9 million payday loan transactions were made in the state, www.nccob.gov/Public/docs/News/Pub%20And%20Research/Check%20Cashers%20Report%20to%20Gen%20Assembly.pdf. Or for a discussion of payday lending in North Carolina and Georgia, including figures on stores in those states operated by major national lenders, see Donald P. Morgan and Michael R. Strain, "Payday Holiday: How Households Fare after Payday Credit Bans," (2007).

58 During the period of inquiry in our survey, the five years prior to the survey being administered, or roughly late 2006 to early 2012, 10 states implemented substantial changes to the laws regulating payday lending in their state. Five jurisdictions—Arizona, Arkansas, the District of Columbia, Montana, and New Hampshire—became newly Restrictive between January 2008 and January 2011. In Arizona, the legislation authorizing payday lending in the state expired; the other four jurisdictions implemented double-digit APR rate caps. Five additional states moved into the Hybrid category in recent years. Colorado and Virginia implemented longer minimum loan terms, among other regulations, and Rhode Island lowered the fees that may be charged for a payday loan. Washington State capped at eight the number of loans borrowers may take out each year. Oregon reduced allowable fees and now requires a 31-day minimum loan term.

59 Signe-Mary McKernan, Caroline Ratcliffe, and Daniel Kuehn. "Prohibitions, Price Caps, and Disclosures: A Look at State Policies and Alternative Financial Product Use" Urban Institute, (November 2010).

60 This publication does not present data related to the issue of whether borrowers could be substituting other forms of credit for storefront payday loans.

61 For example, "House Mulls Reviving Payday Loans," *New Hampshire Business Review*, www.nhbr.com/businessnewsstatenews/935663-257/house-panel-mulls-reviving-payday-loans.html.

62 For example, Alexandra Alper, "Complaints vs. Banks Drop, Payday Lenders Rise," *Reuters,* (March 1, 2012), www.reuters.com/article/2012/03/01/financialregulation-bbb-idUSL2E8E1FMB20120301.

63 The Better Business Bureau reports that complaints against payday lenders increased 159 percent from 2010 to 2011. Figure available at: http://tulsa.bbb.org/article/Complaints-Down-But-Huge-Jump-in-Inquiries-Means-Shoppers-Are-Doing-Their-Homework-33509.

64 "Washington State Department of Financial Institutions, 2010 Payday Lending Report," www.dfi.wa.gov/cs/pdf/2010-payday-lending-report.pdf.

65 Data obtained by Pew in telephone calls and e-mails with state regulators.

66 These figures are fairly consistent with estimates from Stephens Inc., that roughly one-quarter of payday loan volume is online. Our survey data suggest just under one-quarter of traditional (storefront or online, but not "other") payday loan borrowers have borrowed online. Note that the 7 percent "other" finding may include products from banks or employers but should not be taken as a general estimate of bank payday or "deposit advance" lending.

67 "Digital Differences," Pew Internet & American Life Project, (2012), www.pewinternet.org/~/media//Files/Reports/2012/PIP_Digital_differences_041312.pdf.

68 McKernan, Ratcliffe, and Kuehn. "Prohibitions, Price Caps, and Disclosures," (2010).

The Safe Small-Dollar Loans Research Project focuses on small-dollar credit products such as payday and automobile title loans, as well as emerging alternatives. The project works to find safe and transparent solutions to meet consumers' immediate financial needs.

The Pew Charitable Trusts is driven by the power of knowledge to solve today's most challenging problems. Pew applies a rigorous, analytical approach to improve public policy, inform the public, and stimulate civic life.

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Exhibit C

THE PEW CHARITABLE TRUSTS

PAYDAY LENDING IN AMERICA:
REPORT 2

How Borrowers Choose and Repay Payday Loans

February 2013

This is the second report in a series, *Payday Lending in America*, that presents original research findings from Pew's safe small-dollar loans research project on how to create a safe and transparent marketplace for those who borrow small sums of money.

www.pewtrusts.org/small-loans

FEBRUARY 2013

The Pew Charitable Trusts is driven by the power of knowledge to solve today's most challenging problems. Pew applies a rigorous, analytical approach to improve public policy, inform the public, and stimulate civic life.

The safe small-dollar loans research project focuses on small-dollar credit products such as payday and automobile title loans, as well as emerging alternatives. The project works to find safe and transparent solutions to meet consumers' immediate financial needs.

THE PEW CHARITABLE TRUSTS
Susan K. Urahn, executive vice president
Travis Plunkett, deputy director

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The report benefited from the insights and expertise of an external reviewer, Alan M. White, professor of law at the City University of New York. Additionally, survey research expert Mike Mokrzycki reviewed the report and provided valuable feedback in the design of our survey and methodology. These experts have found the report's approach and methodology to be sound; neither they nor their organizations necessarily endorse its conclusions.

For additional information, please visit www.pewtrusts.org/small-loans.

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Contents

Introduction

Twelve million Americans take out payday loans each year when they are in difficult financial situations. As they weigh choices for addressing a cash shortfall, payday borrowers consider both formal credit and informal options, including cutting back on expenses, borrowing from family or friends, delaying bills, or selling or pawning items, as described in Pew's first payday lending report.[1] Borrowers mostly describe themselves as trying to keep up with their expenses, often by using noncredit alternatives rather than explicitly comparing credit options. They are very familiar with debt and are not eager to take on more.

In deciding whether to borrow from a payday lender, more than 3 in 4 borrowers rely on lenders to provide accurate information about the product, and lenders describe loans as "safe,"[2] "a sensible financial choice,"[3] and "the best alternative to meet their current needs"[4] for a "one-time fixed fee."[5] The product's stated two-week duration appeals to the borrower's desire for a quick cash infusion as well as the conflicting desire not to be in ongoing debt. In reality, both desires cannot be met. But a payday loan's unrealistically short repayment period suggests otherwise by enabling people in difficult situations to think that the loan can solve their problem at an affordable fixed cost so they can avoid asking for help, cutting back further, or creating another ongoing bill.

The ultimate cost and duration of the loans are highly unpredictable and bear little resemblance to their two-week packaging. Average borrowers end up indebted for five months, paying $520 in finance charges for loans averaging $375,[6] largely because they see their only choices as making a lump-sum repayment retiring their entire debt, which they cannot afford, or paying fees to continuously pay back and re-borrow the loan, which they can afford but which does not reduce what they owe. Once they have borrowed, neither choice is viable, leaving them indebted far beyond their next payday. This experience leaves borrowers torn—grateful to have received respectful customer service and credit when they sought it, but feeling taken advantage of by the loan's cost and frustrated by the difficulty of repayment.

This report, "How Borrowers Choose and Repay Payday Loans," the second in Pew's *Payday Lending in America* series, answers several important questions: If payday loans are unaffordable, why do people choose them? How can they eventually pay them back at all? And what are the consequences of using a loan that is so difficult to repay?

This report looks at individuals' decision processes to see why they borrow instead of cutting back expenses or choosing other options, and how they fare using the loans. The results indicate that the choice to use a payday loan often leaves borrowers needing to use these other alternatives to ultimately pay off the loan. Many payday borrowers find themselves overdrafting their checking accounts, indebted for the long term, or borrowing from family and friends anyway to repay their loan—options that were available to them instead of a payday loan in the first place.

The findings will demonstrate to policymakers and other readers the significant failures in the small-dollar loan marketplace, where millions of cash-strapped individuals are using payday loans that they cannot afford to repay in full by the nominal due date. Yet the loans continue to be marketed as a fixed-price, short-term solution. The Consumer Financial Protection Bureau has the authority to regulate payday lending at the federal level, along with prudential bank regulators such as the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation. As these regulators are aware, some banks are also participating in the small-dollar lending market through their deposit advance loan products. At the state level, policymakers have several options. Some have chosen to eliminate payday lending stores, and these policies have been effective at reducing payday loan usage without driving an increase in online or other forms of payday lending. In other states, policymakers have sought to mitigate the potential harm of high-interest credit by capping rates below the industry average, limiting usage, or requiring that borrowers be allowed more than two weeks to repay the loan. But in a majority of states, none of these protections are in place.

Key Findings of this Report

1 Fifty-eight percent of payday loan borrowers have trouble meeting monthly expenses at least half the time. These borrowers are dealing with persistent cash shortfalls rather than temporary emergencies.

2 Only 14 percent of borrowers can afford enough out of their monthly budgets to repay an average payday loan. The average borrower can afford to pay $50 per two weeks to a payday lender—similar to the fee for renewing a typical payday or bank deposit advance loan—but only 14 percent can afford the more than $400 needed to pay off the full amount of these non-amortizing loans. These data help explain why most borrowers renew or re-borrow rather than repay their loans in full, and why administrative data show that 76 percent of loans are renewals or quick re-borrows while loan loss rates are only 3 percent.

3 The choice to use payday loans is largely driven by unrealistic expectations and by desperation. Borrowers perceive the loans to be a reasonable short-term choice but express surprise and frustration at how long it takes to pay them back. Seventy-eight percent of borrowers rely on lenders for accurate information, but the stated price tag for an average $375, two-week loan bears little resemblance to the actual cost of more than $500 over the five months of debt that the average user experiences. Desperation also influences the choice of 37 percent of borrowers who say they have been in such a difficult financial situation that they would take a payday loan on any terms offered.

4 Payday loans do not eliminate overdraft risk, and for 27 percent of borrowers, they directly cause checking account overdrafts. More than half of payday loan borrowers have overdrafted in the past year. In addition, more than a quarter report that overdrafts occurred as a result of a payday lender making a withdrawal from their account. Although payday loans are often presented as an alternative to overdrafts, most payday borrowers end up paying fees for both.

5 Forty-one percent of borrowers have needed a cash infusion to pay off a payday loan. Many of these borrowers ultimately turn to the same options they could have used instead of payday loans to finally pay off the loans, including getting help from friends or family, selling or pawning personal possessions, or taking out another type of loan. One in six has used a tax refund to eliminate payday loan debt.

6 A majority of borrowers say payday loans take advantage of them, and a majority also say they provide relief. The appreciation for urgently needed cash and friendly service conflicts with borrowers' feelings of dismay about high costs and frustration with lengthy indebtedness.

7 By almost a 3-to-1 margin, borrowers favor more regulation of payday loans. In addition, two out of three borrowers say there should be changes to how payday loans work. Despite these concerns, a majority would use the loans again. In a state where payday storefronts recently stopped operating, former borrowers are relieved that payday loans are gone and have not sought them elsewhere.

Summary of Report 1— Who Borrows, Where They Borrow, and Why (2012)

Although payday loans are characterized as a short-term solution for unexpected expenses, most borrowers use them for everyday bills. The average borrower is in debt for five months during the year, spending $520 on interest.

1 Who Uses Payday Loans? Twelve million American adults use payday loans annually. Pew's survey found that most payday loan borrowers are white, most are female, and most are 25 to 44 years old. However, after controlling for other characteristics, there are five groups that have higher odds of having used a payday loan: home renters, those earning below $40,000 annually, those without a four-year college degree, those who are separated or divorced, and African Americans.

2 Why Do Borrowers Use Payday Loans? Sixty-nine percent of first-time payday borrowers used the loan to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food, while 16 percent dealt with an unexpected expense, such as a car repair or emergency medical expense.

3 What Would Borrowers Do Without Payday Loans? If faced with a cash shortfall and payday loans were unavailable, 81 percent of borrowers say they would cut back on expenses such as food and clothing. Majorities also would delay paying bills, borrow from family or friends, or sell or pawn possessions.

4 Does Payday Lending Regulation Affect Usage? In states that enact strong legal protections, the result is a large net decrease in payday loan usage (overall usage is 2.9 percent in the most stringently regulated states, compared with 6.6 percent in states with the least regulation). Borrowers are not driven to seek payday loans online or from other sources as a result of state regulation. In states with no stores, just 5 out of every 100 would-be borrowers choose to obtain payday loans online or from alternative sources, while 95 choose not to use them.

Report 1 findings were based largely on 33,576 interviews from an omnibus survey, 451 follow-up interviews with storefront payday loan borrowers, and state regulatory and industry data. For more information and a copy of Report 1, see www.pewtrusts.org/small-loans.

1 Payday Borrowers Routinely Struggle to Meet Expenses

"I'm like everybody else, living paycheck to paycheck, still not having enough to come through at the end."

—Online borrower, Manchester, NH

Most payday borrowers are dealing with persistent cash shortfalls. The Pew survey found that 58 percent of payday loan borrowers have trouble meeting their regular bills at least half the time, including more than one-third who say they have trouble meeting their bills most of the time. Just 1 in 7 never have trouble meeting their regular monthly bills and expenses.

These findings reinforce those of Pew's first paper in the *Payday Lending in America* series: Although payday loans are frequently described as intended for unexpected expenses, keeping up with regular bills is the primary reason that borrowers use payday loans.[7] That study found that 69 percent of storefront borrowers reported using their first payday loan to meet a recurring expense, and just 16 percent said it was for an unexpected expense. Pew's survey data specifically covering online borrowers show similar results, at 73 percent and 16 percent, respectively.

"For instance, like today is what, sixth, seventh? The rent is due on the first. I didn't pay it. I will in the next few days, but it seems like I'm always struggling to catch up in order to stay afloat."

—Online borrower, New York

"It seems like you never catch up, and it, it's just check-to-check, and something breaks down, and the house needs work, kids have school, just never catch up." [And how long have you felt that way?] "Twenty years."

—Storefront borrower, Chicago

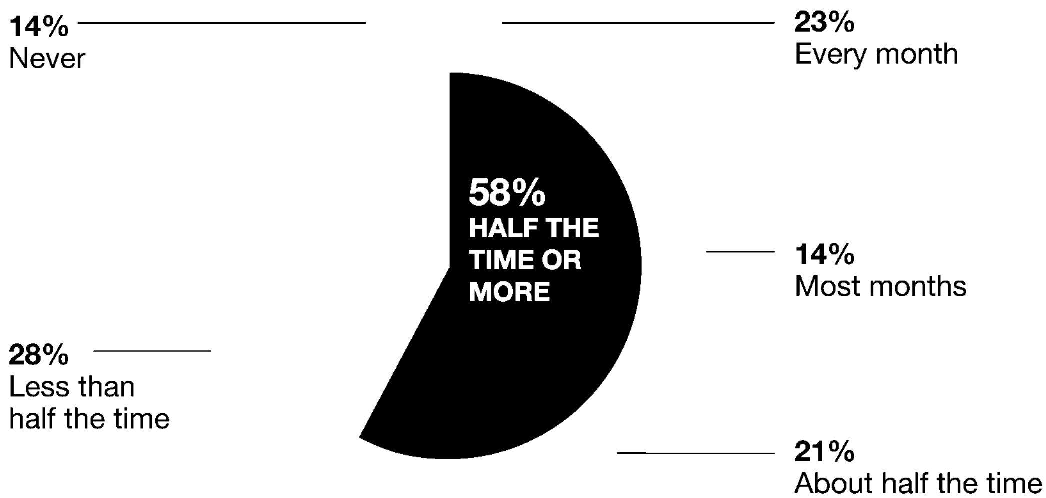
Borrowers Split on How They Rate Their Own Economic Situation

Half of payday borrowers describe their economic situation as "good," and half describe it as "bad," based largely on how often they can keep up with their bills. In focus groups, very few borrowers

EXHIBIT 1:

MAJORITY OF PAYDAY BORROWERS HAVE TROUBLE MEETING BILLS AT LEAST HALF THE TIME

FREQUENCY OF TROUBLE MEETING BILLS:



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "How often, if ever, do you have trouble meeting your regular monthly bills and expenses?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

described themselves as having savings or a financial cushion, and many felt that in their current economic situation, it was not possible to "catch up" or save for the future.

Among employed payday loan borrowers, 20 percent have multiple jobs, and in focus groups, several borrowers explained that a second job was critical to allow them to meet basic expenses. Others with one job were dependent on the income of another household member and said the loss of a second household income would leave them unable to pay regular bills. Previous research has found that 25 percent of small-dollar loan borrowers reported a loss of income, such as a job loss or reduction in hours, as a reason for a shortage of funds.[8]

"I work a couple jobs, and I have my teenagers that I put through Catholic high schools and colleges. … And then the bills just keep coming, too, just constant bills."

—*Storefront borrower, Chicago*

"I don't want to look anybody in the eye and admit that I can't even break even."

—*Online borrower, Manchester, NH*

"My husband has been unemployed for the last two years, and it's been a struggle to make it. I hope that he gets a job any day so we don't have to be quite so tight on the budget. And my son is leaving to go into the Air Force."

—*Storefront borrower, Birmingham, AL*

"[I have a] full-time job at the sheriff's office [where] I'm taking a 20 percent pay cut, but I have a security job on the side."

—*Storefront borrower, Birmingham, AL*

"I've had a part-time job like for the last four years after my divorce, [but] the finances aren't like they were. … I got a second job."

—*Storefront borrower, Birmingham, AL*

"[The] only light bulbs in my house are in the kitchen, the bathroom, and … none in the bedroom. No bill in there is going to be over $100, no bill at all."

—*Storefront borrower, Chicago*

WHAT IS A BANK DEPOSIT ADVANCE LOAN?

A deposit advance loan is a payday loan for up to $500 that some banks offer to customers who have direct deposit. The structure mimics a conventional payday loan, with the entire loan plus interest due on the borrower's next payday. The cost—$7.50 to $10 per $100 per pay period, resulting in annual percentage rates (APRs) of 196 to 261 percent for a 14-day loan—is somewhat lower than that of a typical storefront loan ($10 to $20 per $100 per pay period, or 261 to 521 percent APR). The loans are secured by the customer's next direct deposit, and the bank repays itself immediately when that deposit is received. Depending on the bank, the loans may be advertised in branches, by direct mail, through email, at ATMs, or on a bank's website.

Previous research indicates that although bank deposit advances are advertised as two-week products, average customers end up indebted for nearly half the year, similar to the experience of payday loan customers borrowing from storefronts.[i] In Pew's focus groups, bank deposit advance borrowers explained that, once the bank has withdrawn the full amount plus interest, they frequently cannot meet their expenses and, like store-front and online payday borrowers, must re-borrow the loan amount.

EXHIBIT 2:

BANK DEPOSIT ADVANCE LOANS MIMIC PAYDAY LOAN MODEL

		BANK DEPOSIT ADVANCE LOAN
Advertised term	**One pay period with lump-sum repayment (about two weeks)**	**One pay period with lump-sum repayment (about two weeks)**
Amount loaned	**Usually up to $500**	**Usually up to $500**
Most common advertised price	**$15 per $100 per pay period**	**$10 per $100 per pay period**
Annualized interest rate on a 2-week loan (APR)	**391 percent**	**261 percent**
Security provided to lender	**Post-dated check or electronic debit authorization for borrower's account at third-party institution**	**Electronic debit authorization for borrower's account held by the lender**
Requirements to borrow	**Income stream, checking account**	**Income stream, checking account with direct deposit at this bank**
Borrower experience	**Average borrower indebted 5 months during year; ¾ of loans are quick re-borrows**	**Available evidence shows similar patterns as conventional payday loans**

SOURCES: "Payday Lending in America: Who Borrows, Where They Borrow, and Why." The Pew Charitable Trusts. (2012); "Big Bank Payday Loans." Center for Responsible Lending. (2011); Consumer Financial Protection Bureau."Examination Procedures: Short-Term, Small-Dollar Lending." January 19, 2012. Available at: http://files.consumerfinance.gov/f/2012/01/Short-Term-Small-Dollar-Lending-Examination-Manual.pdf; Fed. Reg. 76. 33409-33413. Guidance on Deposit-Related Consumer Credit Products. Notice by the Comptroller of the Currency. June 8, 2011; Bank-specific cost information comes from the websites of banks offering deposit advance loans. Pew's safe small-dollar loans research project, 2013.

i Center for Responsible Lending. "Big Bank Payday Loans." (2011). Available at: http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf

2 Renewing Payday Loans Is Affordable, but Paying Them Off Is Not

"If you can't pay that money back when you … agreed to, they let you just pay the interest, and then it gets easier and easier for you to renew that loan, because you're saying, well, I need to do this with this money, and I can pay this $17.50 or $35 and go ahead on."

—Storefront borrower, Birmingham, AL

The vast majority of payday loan users are repeat borrowers who pay fees to renew or re-borrow the loans, accounting for nearly all of lender profitability.[9] Available data demonstrate the depth of this problem:

The average payday borrower is indebted for five months during the year.[10]

Four in five borrowers use three or more loans per year and account for 97 percent of all loans.[11]

One in five borrowers use payday loans only once or twice per year, accounting for just 3 percent of all loans.[12] Notably, these borrowers are not profitable for lenders and are not the focus of the payday loan business model.[13]

More than 60 percent of all loans go to people using 12 or more loans per year.[14]

Seventy-six percent of loans are renewals or quick re-borrows.[15]

Lump-Sum Repayments Far Exceed Borrowers' Means

Pew's survey asked how much borrowers can afford to pay toward their payday loan debt and still afford their regular bills and expenses. As shown in Exhibit 3, the average borrower reported being able to pay $100 per month, or about $50 per two weeks. However, the typical borrower owes $430 ($375 plus a fee of $55) in two weeks for a storefront loan.[16] Only 14 percent of borrowers can afford enough out of their monthly budgets to pay off an

EXHIBIT 3:

AVERAGE PAYDAY BORROWER CAN AFFORD $100 PER MONTH

NOTE: Data represent percentage of payday borrowers who gave an answer that fell in this range. Respondents were asked: "How much can you afford to pay each MONTH toward (an online payday loan/a payday loan) and still be able to pay your other bills and expenses?" All responses were volunteered and not read aloud as options to select. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

average payday loan. As Exhibit 4 shows, the average borrower can barely afford just the $55 fee required to renew an average storefront loan for another two weeks.

Even among those who describe their financial situation as very or fairly good, only 15 percent can afford to pay more than $400 toward their payday loan debt in a month. Borrowers explained in focus groups that this incompatibility between the loans' required payment and their ability to pay caused them to renew or re-borrow the loans for months before they could pay them off. This finding about unaffordability helps explain why the average borrower ends up indebted for five months of the year.[17]

EXHIBIT 4:

RENEWALS ARE AFFORDABLE, REPAYMENT IS NOT

Average borrower can afford (per two weeks)

$50

With $50 available, the borrower has two options for each type of loan, to pay it off or renew:

	Amount Due in Two Weeks to Pay Off a Loan of $375[i]		Amount to Renew or Re-borrow Loan for Two More Weeks, Without Paying Down Principal
STOREFRONT PAYDAY LOAN	$430 (principal + fee of $55)	OR	$55
ONLINE PAYDAY LOAN	$470 (principal + fee of $95)	OR	$95
BANK DEPOSIT ADVANCE LOAN[ii]	$412.50 (principal + fee of $37.50)	OR	$37.50

NOTE: Respondents were asked: "How much can you afford to pay each MONTH toward (an online payday loan/a payday loan) and still be able to pay your other bills and expenses?" Results are based on 703 interviews conducted from December 2011 through April 2012.

[i] The average cost of storefront and online payday loans is discussed in Pew's first report in this series and comes from Stephens Inc. (2011).

[ii] "Big Bank Payday Loans." Center for Responsible Lending. (2011). Bank-specific cost information can also be found at https://www.usbank.com/checking/caa/index.html, https://www.wellsfargo.com/checking/direct-deposit-advance/, http://www.regions.com/personal_banking/ready_advance.rf, https://www.53.com/doc/pe/pe-eax-faq.pdf, http://www.guarantybanking.com/SiteContent/5871/final%20ea%20service%20agreement%20(gb)%207-31-10.pdf, and https://www.bankofoklahoma.com/sites/Bank-Of-Oklahoma/asset/en/theme/default/PDF/Bank%20of%20Oklahoma%20FastLoan SM%20Terms%20and%20Conditions.pdf.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"It only costs me $45, but I can't live without that $255 at the same time. I've got to take out the loan again every paycheck. As much as I would just like to say, 'Here's the $300, I'm good. I don't want another loan,' I can't. Because if I do, that $255 that I don't have, what am I going to do? That's anything from like rent, other bills, food, cost of living stuff. It's difficult."

—Storefront borrower, San Francisco

"Paying $500 now, I mean, that's where the, kind of the vicious circle comes in. Now you almost have to at least get some of it back so you have enough to make it to the end of the month."

—Storefront borrower, Birmingham, AL

"I mean, to all of a sudden, 'Oh, you owe us $500. You got to pay now.' That's tough for anybody; you know what I mean? It's hard to come up with $500."

—Storefront borrower, Chicago

"Well, Friday came, you gave them your pay, what you owed them, which cleared off that loan, but now you have nothing, so you have to re-borrow to survive the week or two weeks."

—Former storefront borrower, Manchester, NH

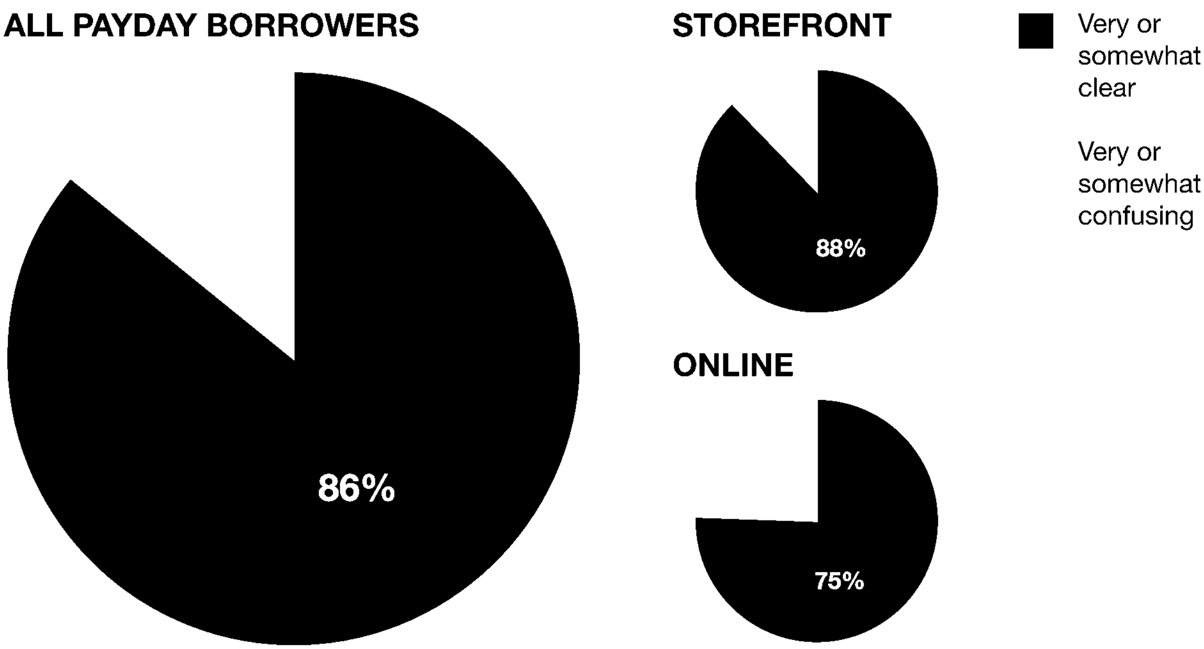
Most Borrowers Say Terms Are Clear but Still Struggle to Repay

Although most borrowers cannot afford to repay their payday loans, large numbers state that the terms and conditions were clear. Focus group participants often described the terms as unfair, usually meaning very expensive, but most said they understood what the fee was and when the loan was due, and in that way they thought the terms were clear. A significantly higher number of storefront borrowers than online borrowers thought the terms were clear.

The average storefront payday loan requires a $430 repayment in two weeks. Pew's survey found that even among those who said the loan terms were very clear, just 46 percent of borrowers could afford a repayment of more than $100 a month, and just 14 percent said they could pay more than $400 a month.

EXHIBIT 5:

SIX IN SEVEN BORROWERS SAY TERMS AND CONDITIONS ARE CLEAR



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "When you took out (that FIRST/the) (online payday loan/payday loan), would you say the terms and conditions of the loan were very clear, somewhat clear, somewhat confusing, or very confusing?" Data for online do not add to 100% because "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"It's really basic. If you're taking out $300 and they're charging you $90, you pay $390. If you do not pay it back in two weeks, you're paying $90 out of your check every two weeks until you pay the full amount."

—*Online borrower, New York*

"I do agree [with other borrowers that loans take advantage of you], but you know up front what you're getting into."

—*Storefront borrower, Birmingham, AL*

"You know the interest rate is 17 percent. I mean, so you know before you get it what you're going to have to pay back."

—*Storefront borrower, Birmingham, AL*

"I think they're honest, but I don't think it's really fair. I mean, it's a really high interest rate."

—*Storefront borrower, Chicago*

PAYDAY LOAN LOSS RATES

Loss rates at the larger payday lenders are about 3 percent of funds ($2.98 per $100 lent), according to industry analyst calculations,[i] suggesting that 97 percent of payday loans (including extensions and renewals) are eventually repaid.[ii] No comparable data are available for deposit advance loans, but given that the loans are secured by the borrower's direct deposit to an account owned by the lender, it is likely that the loss rate is even lower.

In focus groups, borrowers stated they were eager to pay back loans, both to meet their obligations and to maintain future access to credit. These sentiments are consistent with relatively high rates of repayment and with prior research that found little evidence of strategic default.[iii]

i Stephens Inc. "Payday Loan Industry." (2011)

ii Using 2011's Annual (10-K) Report from Advance America, the largest storefront lender, as an example, we can calculate an approximate loss rate by dividing the "provision for doubtful accounts" by the "aggregate principal amount of cash advances originated." This calculation of $107,911,000 divided by $3,965,225,000 yields an estimated loss rate of 2.72 percent. Borrowers may renew or re-borrow a loan, or experience temporary defaults by bouncing checks and incurring nonsufficient funds fees while still paying back a loan eventually. Advance America has made a similar point, stating, "97 percent of our customers pay us back." http://www.ncsl.org/portals/1/documents/fiscal/Jamie_Fulmer_PowerPoint.pdf

iii Paige Marta Skiba and Jeremy Tobacman. "Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default." (2008). Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1319751

3 Why People Borrow When They Can Afford Only to Renew, Not to Repay

"You don't know that it's going to take you six months when you're going into it, to pay."

—Online borrower, New York

Payday borrowers renew or re-borrow loans because they cannot afford to repay them in full. But why do people choose to borrow unaffordable loans in the first place? The answer is not the same for every borrower, but our research reveals several contributing factors.

One clear reason is desperation. More than one-third of borrowers say they have been in such a difficult situation that they would take a payday loan on any terms offered. Another reason is that many borrowers struggle with the temptation of having cash readily available to them, describing payday loans as "too easy" to obtain.

Borrowers also hold unrealistic expectations about payday loans. In focus groups, people described struggling to accommodate two competing desires: to get fast cash and to avoid taking on more debt. They cited the "short-term" aspect of payday loans as a reason for their appeal and described how a payday loan appeared to be something that could provide needed cash, for a manageable fixed fee, without creating another ongoing obligation. However, this perception does not match reality: Borrowers typically experience prolonged periods of debt,[18] paying more than $500 in fees over five months.[19]

Lenders benefit from this misperception, because they rely on borrowers to use the loans for an extended period of time. Prior research shows that the payday loan business model requires repeat usage in order to be profitable,[20] with nearly all loans going to repeat users. (Ninety-seven percent of loans go to people using three or more loans per year, and 60 percent go to those using at least 12 loans per year.[21]) Yet lenders continue to structure their loans as a two-week fixed-fee product. They routinely promote the loans as a short-term solution that should not be used on a long-term basis,[22] even though the loans' unaffordability makes this long-term use widespread. These efforts help shape the expectations of borrowers, who say they rely on lenders to give them accurate information by a nearly 4-to-1 margin. When asked to reflect on their experiences, borrowers expressed surprise over how long it actually took to pay off the loans, as well as frustration about how difficult that was to predict.

Taken together, these and other findings presented below help explain why people select an unaffordable loan.

Some Borrowers Have Been in Situations Where They Would Accept Any Terms Offered

Thirty-seven percent of payday borrowers have at some point felt that they would take a loan on any terms offered. This figure rises to 46 percent among those who rate their financial situation as fairly or very bad.

EXHIBIT 6:

SIX REASONS WHY PEOPLE USE PAYDAY LOANS THEY CANNOT AFFORD

1 Desperation
More than one-third of borrowers say they have been in such a difficult situation that they would take a payday loan on any terms offered.

2 Perception
Borrowers perceive that payday loans do not create ongoing debt, or are "not another bill," although the loans do in fact create high-cost, ongoing debt.

3 Reliance
Borrowers rely on lenders for accurate information. Lenders sell payday loans that are packaged as a two-week product, although the borrower ends up indebted for five months on average.

4 Focus on fee
Borrowers focus on being able to afford the finance fee, rather than on how the lump-sum repayment will affect their budget.

5 Trust
Some bank deposit advance borrowers believe that bank payday loans are safer or more regulated than other payday loans.

6 Temptation
Some borrowers consider the loans "too easy" to obtain, because they are readily available, and borrowers have a consistent cash shortfall.

SOURCE: Pew's safe small-dollar loans research project, 2013.

These borrowers accept an unaffordable loan for the simple reason that it allows them to stay solvent for two more weeks, regardless of cost. Previous research has also found that most customers do not comparison shop for small loans and instead focus on obtaining money quickly, demonstrating that when people are in an urgent situation, speed rather than affordability is paramount.[23]

EXHIBIT 7:

37%

NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "Have you ever felt you were in such a difficult situation that you would take (an online payday loan/a payday loan) on pretty much any terms offered or have you never felt that way?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"If you're that desperate then you almost do any terms."

—Storefront borrower, Manchester, NH

"You don't think about the cost of funds in an emergency. That's basically it."

—Storefront borrower, San Francisco

"I mean you cannot choose—not as completely as you probably should. ... I am going to have to pay more later when I pay this off but we'll cross that bridge in two weeks. Right now I think it's just that whole immediacy moment."

—Storefront borrower, San Francisco

"Like the first time I did it, and maybe like the second time, getting the loan wasn't really going to help me out too long term, because I was spending more than I was bringing in. So I got into a real hard spot the first time I did it. And then the second time I did it, because I was desperate, where I ended up having to like extend it, because I needed that money to live on, and then extend it again. And I got in sort of over my head, where it's like now I owe all this money, and you're going to take basically my whole check."

—Storefront borrower, Chicago

"It hurts me to be in a situation where I have to go and accept those types of conditions."

—Former storefront borrower, San Francisco

Borrowers Perceive Payday Loans as 'Not Another Bill'

To some focus group respondents, a payday loan, as marketed, did not seem as if it would add to their recurring debt, because it was a short-term loan to provide quick cash rather than an additional obligation. They were already in debt and struggling with regular expenses, and a payday loan seemed like a way to get a cash infusion without creating an additional bill. Despite this appeal, the reality is that the average borrower ends up indebted to the payday lender for five months of the year.

It is highly unrealistic for borrowers to think that they will repay the loan on their next payday and not need to re-borrow the money (more people use 17-plus loans per year than use just one). But this optimism is consistent with previous research from the behavioral economics field.[24] Previous research has found that people across income levels express unrealistic optimism in assessing their financial prospects in areas such as investment returns, future earnings, or ability to repay loans quickly.[25]

"I thought, 'No I don't want to charge it,' at the time, because I had enough [other bills] to pay. I was already, you know, my limit was getting kind of there."

—*Online borrower, New York*

"I don't want to prolong it too much, and then it becomes another bill, because that's essentially what will happen. If I'm paying over six months, it's just another bill, like I have another extra cable bill or something."

—*Online borrower, New York*

"Because when I kept getting those statements and so forth, I made a decision to pay [the credit cards] off, and I'm not going to get another one … because I don't want to keep paying all that interest."

—*Storefront borrower, Birmingham, AL*

"By my next paycheck, I should be done."

—*Online borrower, New York, who has had a loan out for three months*

"And I think, 'Oh, it'll just be fine next paycheck, just need to get to the next paycheck.' And I need, you know, either pay the bill to keep the lights on, or need some food, or whatever it is."

—*Storefront borrower, Chicago*

Other research in the field has found that people experience "confirmation bias," looking for information to confirm their already-held hope or belief.[26] A loan from a state-licensed lender or federally chartered bank that is marketed as a two-week product serves to confirm an overly optimistic perspective, signaling to borrowers that it is realistic for them to receive quick cash without creating ongoing debt.

Borrowers Rely Heavily on Payday Lenders, Whose Loans Appear to Last for Just Two Weeks

More than three-quarters of borrowers in Pew's survey stated that they rely on the payday lender to provide accurate information, but information is provided only about a two-week product, even though borrowers end up indebted for an average of five months. Because the loans do not amortize, paying just the fee—the salient price that borrowers are instructed to pay if they cannot afford full repayment—does not reduce the amount owed, leaving them no closer to eliminating the debt. Therefore relying on the lender for accurate information makes the ultimate cost and duration of the debt extremely difficult to predict.

Lenders' advertising heavily promotes the concept of relying on and trusting them. One bank describes itself in a payday loan advertisement as "your trusted source"[27] and suggests you "work with a lender you trust."[28] A large storefront payday lender advertises itself as "the name millions trust"[29] and promises, "We're here for you."[30] Other lenders call themselves "a company you can trust"[31] or "someone you can rely on"[32] and explain that they are "here to help you,"[33] encouraging people to "stop by to borrow … money from your friends."[34]

EXHIBIT 8:

MAJORITY COMPLETELY RELY ON PAYDAY LENDERS FOR ACCURATE INFORMATION

NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "How much do you rely on (online payday lenders/payday lenders) to give you accurate information?" Results are based on 703 interviews conducted from December 2011 through April 2012. Data do not add to 100 percent because "Don't know" and "Refused" were omitted from this chart.

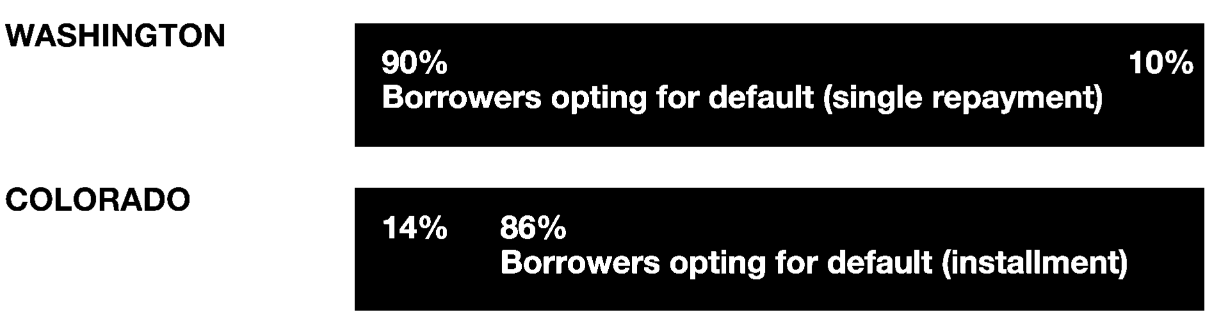
SOURCE: Pew's safe small-dollar loans research project, 2013.

The meaning and implications of this reliance are perhaps best illustrated by comparing how borrowers use payday loans in Washington and Colorado. In Washington, a payday loan's term is for two weeks with a lump-sum repayment, and, as in most states, the majority of payday users re-borrow the loans multiple times.[35] But unlike most states, Washington gives borrowers a no-cost option to convert the loan immediately into a far more affordable[36] 90- to 180-day loan, payable in installments.[37] In 9 of 10 instances, however, borrowers fail to do so, instead accepting the unaffordable default loan structure provided by the lender.[38] This striking data point demonstrates that even when a payday loan could become affordable for borrowers through conversion to an installment loan, the default structure provided by the lender is so influential that most borrowers do not alter that structure.

It would be possible to interpret this inaction as a borrower preference for single-repayment loans, were it not for the example of Colorado, where the default loan structure is for a 180-day term, but borrowers can pay back the loans (with no pre-payment penalty) in two weeks or any other amount of time. Only 1 in 7 pay the loans back in full within a month, with the majority instead accepting the default installment loan structure.[39] As has been found repeatedly in the behavioral economics literature,[40] people tend to accept financial products as they are offered, relying on the structure and choices the provider has established as the default. Payday borrowers are no exception, overwhelmingly accepting the default loan structure that the lender provides them and demonstrating a tremendous degree of reliance on the lender, even when they cannot afford the terms the lender is offering.

EXHIBIT 9:

BORROWERS RELY HEAVILY ON LENDER, ACCEPTING DEFAULT LOAN STRUCTURE



SOURCES: State of Colorado Department of Law; Washington State Department of Financial Institutions; Pew's safe small-dollar loans research project, 2013.

Previous research also found that borrowers do not know the annual percentage rates (APRs) on payday loans,[41] although they are posted in stores and on websites. Instead, borrowers generally know the fee charged per $100 borrowed per pay period. Not knowing a loan's APR makes it hard to compare products, leading to further reliance on lenders. Some in focus groups expressed difficulty in comparing the cost of a payday loan with that of other loan products, such as a credit card. Several borrowers mistook the two-week fee on a payday loan for an interest rate and erroneously compared that with the APR of a credit card.[42] (More information on payday borrowers' use of credit cards is featured on Page 30.)

"I honestly did not think about the fact that once I got paid again ... that it was going to take that money out that I owed them plus with the fee for it. So when that happened I was just like, 'Okay, so now what? I still have to pay [the bills]. ... What do I do?' That's when I had to do it again. I honestly just needed to get that done in that moment and did not think about the consequences too well."

—*Bank deposit advance borrower, San Francisco*

"They just say it in big terms. ... I get real confused when they start talking about the numbers, and I don't read it. I'll be honest, I don't read it. She just said initial here, initial here, initial here, initial here."

—*Storefront borrower, Birmingham, AL*

"Should I pay this whole loan back, or pay the little fee they told me to pay a month? I'm going to pay them a little money."

—*Storefront borrower, Chicago*

"And there's a lot of, there's a lot of nice talk going back and forth, but not a lot of like, you know, understand the steps that are here."

—*Storefront borrower, Chicago*

ALMOST ALL PAYDAY BORROWING IS FOR PERSONAL, NOT BUSINESS, EXPENSES

In developing countries, economists and academics have documented the widespread use of high-cost credit to finance investment in a small business.[i]

Domestically, some business and policy leaders have suggested that small businesses are using payday and other high-cost, very short-term loans to finance their operations.[ii] However, Pew's data show that borrowers almost universally use payday loans to cover personal or family—rather than business—expenses, even among the 6 percent of storefront payday loan borrowers who are self-employed.

i A great deal has been written about the self-employed poor borrowing from money lenders to finance their business operations in developing countries. For example, David Bornstein discusses this practice in "The Price of a Dream: The Story of the Grameen Bank" (2005), and Esther Duflo and Abhijit Banerjee discuss it in "Poor Economics" (2011).

ii The Hispanic Chamber of Commerce argued that small-business owners are using overdraft services and direct deposit advances as credit to finance business operations in a letter from the organization's president, Javier Palomarez, to the Office of the Comptroller of the Currency (OCC) on July 18, 2011. http://www.regulations.gov/#!documentDetail;D=OCC-2011-0012-0038. See also Jim Hawkins, "Credit on Wheels: The Law and Business of Auto Title Lending" (2011), which notes that those claiming that significant numbers of title loan borrowers are using the loans for business reasons have included industry leaders, elected officials, and academics.

EXHIBIT 10:

ALMOST ALL PAYDAY BORROWING IS FOR A PERSONAL OR FAMILY EXPENSE

Personal or family ■ Business

NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "And was that primarily a personal or family expense, or was that primarily for a business that you own or operate?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

Borrowers Focus on the Fee, Rather Than the Whole Repayment

A number of focus group participants explained that when using payday loans, they concentrated just on the fee, which they could afford, rather than the entire repayment, which they usually could not afford without having to borrow again to meet their expenses. Some borrowers talked about the loan fee being affordable, but they had not realized that the full loan repayment would then make it impossible to meet their expenses.

"You can afford that little bit [the loan fee]. It doesn't hurt you."

—Former storefront borrower, San Francisco

"Once my paycheck came, it was like, 'Okay, we're taking this out.' I was like, 'Dang, I should have never done this.' And it was like it took me a while to pay it back. It took me … six months. … Because every two weeks it was something, their amount of money, then I had to pay this, and I had to pay bills."

—Online borrower, New York

"It's just playing with the money. I hand it to you, you hand it back. I hand it to you, you hand it back, you know, and it's only the interest. … Just as long as you pay me $17 on every $100, we're good, you know."

—Storefront borrower, Birmingham, AL

"The first one I paid off in full. That's the thing. I paid it off. I said, 'Here's $400, whatever it was.' ... But then that month, okay, here's my paycheck, $400 gone, and now I have this much left, but I have all these bills. All of a sudden, you're already like, 'Hmmm, I got the short end of the straw.'"

—Online borrower, New York

"You need that money from the next paycheck that is coming, but they take it all, and then you're going to have to find another way to get the money from somewhere to cover that amount."

—Former storefront borrower, San Francisco

"I think [it's safe] because they are through the bank and the bank has FDIC insurance. I don't know. I am just assuming that. I would assume so."

—*Bank deposit advance borrower, San Francisco*

"Well they've got usury laws, don't they? I think probably the payday loans aren't subject to usury laws, but the banks, because they're chartered by federals, they've got a lot of pressure on them to stay within the usury laws."

—*Bank deposit advance borrower, San Francisco*

"For the banks, on the door it says FDIC, so you know it's governed."

—*Bank deposit advance borrower, San Francisco*

"I found out about it because when you do the online banking there is this thing. I hadn't heard about it, and it just says that I can do a direct deposit advance. And I clicked on it, like 'Oh! Really?' And then, well, it's very quick and easy."

—*Bank deposit advance borrower, San Francisco*

"Well, I was a little short and was thinking I could use some more money and I was at the ATM actually, and it was there, offering me a direct deposit advance. So, I thought I would try it. They did it for me. They put it right on the ATM where I was at, so I went for it."

—*Bank deposit advance borrower, San Francisco*

Some Borrowers Believe Bank Deposit Advances Are Safer or More Regulated

Several borrowers in focus groups believed that bank deposit advance products (see Page 12), which have the same lump-sum repayment structure as payday loans, were safer than other types of payday loans and were more inclined to use them. Some focused on the fact that the loan was offered by the bank where they already did business, making it both familiar and convenient. Others mistakenly believed that the products were covered by special federal regulatory protections and therefore were relatively safe to use compared with other payday loan options. In reality, nationally chartered banks that offer deposit advance loans may disregard state usury rate limits and other consumer protection laws, and so far there is relatively little federal regulation of payday and deposit advance lending.[43]

"It could be a little too easy."

—*Storefront borrower, Chicago*

"It [was] tempting when you were just in that dire need."

—*Former storefront borrower, Chicago*

"We press click, we press okay, we say submit, and you know, I agree. But I think it's, it makes it too convenient. It's too easy to do it."

—*Online borrower, Manchester NH*

"It's contradictory, but it's like I wouldn't fall into the trap if I didn't have the option."

—*Online borrower, New York*

"When I paid them off … they'd send me stuff in the mail, we'll give you this, we'll give you this, we'll give you this, you know, and they'd call me on the phone. … I knew what they were up to, you know, because it was so easy to fall right back into that."

—*Former storefront borrower, Manchester, NH*

"It was that quick fix that was too easy."

—*Former storefront borrower, Manchester, NH*

Some Borrowers Describe Getting Payday Loans as 'Too Easy'

In focus groups, borrowers appreciated how easy it is to obtain a payday loan, but in many instances, they described it as "too easy" and said they had difficulty resisting the temptation to borrow. Interestingly, both storefront and online borrowers expressed this sentiment, even though these two groups are different, and they think of storefront and online payday loans as two very different products.

CREDIT CARD USAGE AMONG PAYDAY BORROWERS

Credit cards can be an important source of liquidity for cash-strained households. Although a large portion of payday loan applicants have credit card accounts, many have exhausted their limits.[i] Pew's survey found that 2 in 5 payday borrowers used a credit card in the past year, and most had "maxed out" their credit at some point during the same period.

Among payday borrowers who do not have a credit card, nearly half do not want one, and almost as many have been turned down or expect they would be turned down. In focus groups, many borrowers reported having incurred substantial credit card debt in the past and said that is why they intentionally avoid them. Other borrowers discussed feeling overextended by debt already and said payday loans seemed like a different kind of choice compared with a credit card or longer-term loan, because they expected payday loans to last only a short time.

Still others were confused about the relative costs of credit cards compared with payday loans. For example, one participant mistakenly believed that a credit card's annual percentage rate (APR) of 23.99 would cost more per month than a payday loan (which in his state costs $17.50 per $100 borrowed, or 17.5 percent every two weeks), and others did not disagree.

"Because the interest on … some credit cards [is] 23.99 percent. So if you go charge $300, and then you don't pay that $300 off at the end of the month … they're going to tack that 23.99 percent on to it, so you're going to still be paying more than you would if you had to [get a payday loan]."

—Storefront borrower, Birmingham, AL

"I just never got one because I've seen what it did to my sister."

—Storefront borrower, Chicago

"Well, I got my first credit card when I, I think I was 18, and was probably working like a minimum wage job, and I've not had one since. … I'm still paying it off."

—Storefront borrower, Chicago

"I've had them, and … I just can't deal with it, you know. It's a false money. You pay for it later and more than you plan to."

—Storefront borrower, Birmingham, AL

i Neil Bhutta, Paige Marta Skiba, and Jeremy Tobacman (forthcoming). "Payday Loan Choices and Consequences." This research finds that almost all payday applicants have a credit score, and a majority have credit cards but are mostly maxed out on their credit limits at the time they apply for a payday loan. Available at: http://assets.wharton.upenn.edu/~tobacman/papers/Payday%20Loan%20Choices%20and%20Consequences%2020121010.pdf. Overall, approximately 68 percent of all American adults utilize credit cards (2010 Survey of Consumer Finances. Federal Reserve Bulletin. 2012. http://www.federalreserve.gov/pubs/bulletin/2012/pdf/scf12.pdf).

EXHIBIT 11:

CREDIT CARD SITUATION OF PAYDAY LOAN BORROWERS

41%
Have used one this year and not been maxed out

4%
None/don't know

11%
Making payments on one/not used in past year

59%
Have used one this year and been maxed out

38%
Applied and turned down/would be declined

47%
Do not want one

NOTE: Data represent percentage of payday loan borrowers who gave the listed answer. Respondents were asked: "I'm going to read several types of financial products and services. For each one, please tell me whether you have used that product or service in the past year. Have you used a credit card in the past year?" (If "Yes") "In the past year, have you maxed out or been at the top of your credit limit on any of your credit cards?" (If "No") "Have you not used a credit card in the past year because you do not want one, because you think you would not be approved to get one, you are already making payments on one, or did you apply for one and were turned down?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

4 Most Payday Borrowers Are Also Overdrafting Their Checking Accounts

"And even if you tell them the money is not there, guess what? They're going to put that check through and it's going to bounce two times before they come back and say, 'well, can you send us another check?' So now you have two extra fees on your bank account."

—Storefront borrower, Chicago

Payday loans are sometimes promoted as a cost-effective alternative to checking account overdrafts. (A major storefront and online payday lender encourages borrowers to "use payday loans to stop a bank overdraft or NSF fee,"[44] and a prominent online payday loan website states, "avoid costly overdraft fees and charges!"[45]) However, more than half of payday loan borrowers report having overdrafted their accounts in the past year,[46] and 27 percent report that a payday lender making a withdrawal from their bank account caused an overdraft. Moreover, Pew's prior research has shown that the vast majority of those who overdraw their accounts do so by mistake, not by intention. Although people choose payday loans in order to avoid overdrafts, many end up paying payday loan fees and overdraft fees as well.[47]

Payday Loans Not Eliminating Overdrafts

Although it is unclear how much payday borrowing may reduce or increase the likelihood of checking account overdrafts, Pew's research shows that payday loans do not eliminate overdraft risk. Prior research has found that some payday loan borrowers are explicitly choosing to use the loans to avoid overdrafts and bounced checks,[48] but Pew's survey research demonstrates that borrowers are incurring overdraft fees anyway.

EXHIBIT 12:

MAJORITY OF PAYDAY BORROWERS HAVE OVERDRAFTED IN THE PAST YEAR

NOTE: Data represent percentage of payday loan borrowers who gave the listed answer. Respondents were asked: "I'm going to read several types of financial products and services. For each one, please tell me whether you have used that product or service in the past year. Have you used overdrafting on your checking account in the past year?" Results are based on interviews with the 565 payday borrowers in the survey who still had a checking or savings account at the time they took the survey. Interviews were conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

There is less evidence about overdrafts related to bank deposit advance loans, but those loans' single-repayment structure makes it likely that they will be of limited help to customers trying to avoid overdrafts. Corroborating evidence comes from a large financial services consultant that developed a deposit advance loan program for banks and originally promoted the program as a new source of revenue that would result in little to no "overdraft revenue cannibalization."[49] Its analysis indicates that deposit advance loans provide little to no value in helping borrowers avoid overdrafts.

Previous research on the relationship between payday loan usage and overdrafts has yielded mixed results. One study looked at county-level data nationwide and found that access to payday loans was associated with increased levels of involuntary bank account closures, generally because of overdrafts.[50] Another

Twenty-seven percent of borrowers report that a payday lender making a withdrawal from their bank account *caused* an overdraft.

study found that when payday loans were no longer available in two states, bounced checks increased in one state but not the other.[51] A third study showed similar levels of nonsufficient funds (NSF) and overdraft fees paid per household in states that had payday loan stores and in states that did not.[52]

In focus groups, borrowers overwhelmingly agreed that they would not use overdrafts as an alternative to payday loans because, as a credit source, they would be too expensive. These sentiments are consistent with a national survey from Pew's Safe Checking in the Electronic Age Project, which found that 90 percent of those who overdrew their accounts did so by mistake rather than by choice.[53]

PAYDAY LOAN BORROWERS USE PREPAID CARDS AT THREE TIMES THE NATIONAL RATE

Thirty-eight percent of payday loan borrowers report having used a prepaid debit card[i] in the past year, triple the rate at which the general population uses these products.[ii] Prepaid cards are often advertised as a way to avoid checking account overdraft fees and credit card debt, perhaps explaining their appeal to payday loan users, who are eager to avoid both of these.[iii] Prepaid cards also can function much like a checking account for those who do not have one and can be used to budget and compartmentalize spending. For more on prepaid cards, please visit www.pewtrusts.org/prepaid.

i This data point refers to usage of general purpose reloadable (GPR) prepaid cards.

ii Javelin Strategy & Research found that 13 percent of American adults used a prepaid card in 2011. http://www.businessweek.com/news/2012-04-11/prepaid-card-use-up-18-percent-as-consumers-drop-debit-study

iii For example, one of the largest providers of prepaid debit cards, Green Dot, focuses its marketing on the fact that its cards do not have overdraft fees or lead to credit card debt: https://www.greendot.com/greendot

Payday Loans Causing Overdrafts

Among storefront borrowers, 23 percent report that a payday lender attempting to make a withdrawal from their account caused an overdraft. Among online borrowers, 46 percent had this experience.[54] This significant difference was reflected in Pew's focus groups: Online borrowers experienced many more problems as the result of payday lenders accessing their bank accounts.

These findings—that 52 percent of payday borrowers also report overdrafting their checking accounts, and that for 27 percent of borrowers, payday loans are actually causing overdrafts—reveal that payday loans frequently fail to help borrowers avoid overdrafts.

"When I was actually out of town, we had a family member that passed away, and then I missed the date to pay it back, and then I was gone longer than I expected, so I missed a payment. And then they, it was two weeks, and they went and they took it out of my account. And then the overdrafts killed me."

—*Storefront borrower, Chicago*

EXHIBIT 13:

PAYDAY LOANS CAUSING OVERDRAFTS

NOTE: Data represent percentage of payday borrowers who gave the listed answer. Storefront payday borrowers were asked: "For each one I read, please tell me whether it has happened to you. How about Had a payday lender attempt to make a withdrawal that overdrew your bank account?" Online payday loan borrowers were asked: "For each one I read, please tell me whether it has happened to you. How about Had an online payday lender make a withdrawal that overdrew your bank account?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

5 Some Borrowers Use the Same Options to Repay Loans That They Could Have Used Instead of Borrowing

"I finally paid those off, but I would probably still be doing it if it wasn't for my parents helping out with things."

—Online borrower, Manchester, NH

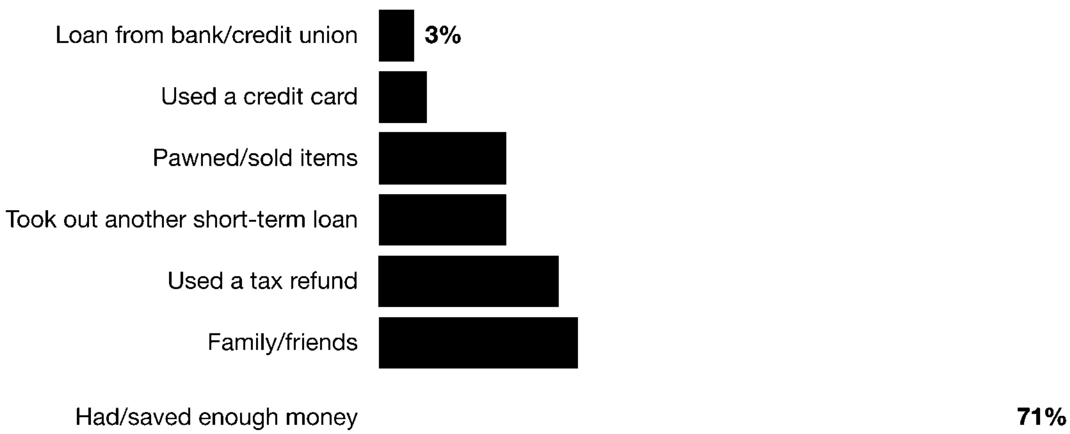
Access to credit is an important tool for people dealing with a cash shortfall, but it would be a mistake to think that people are choosing solely among credit options. Pew's first *Payday Lending in America* report identified a variety of informal or noncredit options that a majority of borrowers said they would employ if payday loans were unavailable: cutting back on expenses, borrowing from family or friends, delaying bills, and pawning or selling items.[55] As explained below, many ultimately turn to the same options they could have used instead of payday loans as a way to pay off the loans.

Pew's survey asked borrowers which methods they have used to pay back a payday loan. Seven in 10 payday borrowers have repaid loans from regular income or savings at least once. Although most borrowers have had or saved enough money to repay a loan at some point, 41 percent have used some other method—asking family or friends for help, waiting for a tax refund, or using another credit product—at least once. Three in 10 borrowers have never been able to repay with income or savings, relying exclusively on one or more alternative strategies.

Some borrowers repaid loans using strategies that they had available to cover their expenses before taking a payday loan in the first place. For example, 19 percent of borrowers received help from family or friends to pay back the loans, and almost all of them report that borrowing from family or friends is an option that would be available to them instead.[56] Similarly, some focus group participants said they chose a payday loan instead of other options but then turned to those same alternatives later to help them resolve their payday loan debt.

EXHIBIT 14:

TWO IN FIVE PAYDAY BORROWERS REPAY USING HELP, WINDFALL, OTHER LOANS



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Survey participants were asked: "Please tell me whether you have or have not used each of the following methods to pay back (an online payday loan/a payday loan). How about (INSERT)? Have you used this method or not?" Data do not add to 100% because each item was asked separately. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

Also of note is the use of tax refunds. One in six borrowers have used a tax refund to pay off a payday loan, a finding that is consistent with prior research showing that outstanding payday debt decreases when tax refunds are issued.[57] The large windfall provided by a tax refund enables borrowers to repay loan principal that their regular paychecks are not sufficient to cover.[58] Both storefront and online borrowers have used these alternative methods of repayment, demonstrating that this problem applies to both types of loans, and several bank deposit advance users in Pew's focus groups reported the same experience.

Many borrowers ultimately turn to the same options they could have used instead of payday loans as a way to pay off the loans.

"Sometimes I would have good fortune and pay it off, you know, income tax time or whatever."

—Storefront borrower, Birmingham, AL

"I got a credit union loan to pay off all those [online payday loans]."

—Online borrower, New York

"I ended up having to call my parents to bail me out."

—Online borrower, New York

"I mean, we were taking out payday loans to pay payday loans [and that] doesn't make any sense."

—Online borrower, Manchester, NH

"[I paid off the payday loan by] asking some other person for the money, that I know I don't have to worry about this interest, you know, let me pay you back a few dollars at a time."

—Storefront borrower, Chicago

"Let me just do it until I get some kind of windfall to stop at the end."

—Bank deposit advance borrower, San Francisco

"I only did it because I didn't want to ask for any money, ask to borrow from … a friend or anything. I kind of wish I did, you know, because I ended up paying more than I actually borrowed."

—Online borrower, New York

6 Borrowers Feel Relief, but They Also Feel That Payday Loans Take Advantage of Them

"It can be lifesaving, but, yes, it is a trap that's hard to get out of."

—Storefront borrower, Birmingham, AL

Payday borrowers' experiences—receiving credit to cover expenses but then ending up spending far more than suggested by the loan's two-week price tag—lead to complicated and conflicted feelings: gratitude that credit is available to them, appreciation for friendly service, dismay with the high cost, and frustration with lengthy indebtedness.

Borrowers See Loans as Taking Advantage of Them

A majority of borrowers say payday loans take advantage of them, and online borrowers and those who describe their financial situation as "bad" feel this most strongly. Sixty-four percent of this latter group said the loans take advantage, compared with 47 percent of borrowers who rated their financial situation as "good." In focus groups, borrowers who described payday loans as taking advantage focused on the high cost of the loans and the difficulty they have in paying them back.

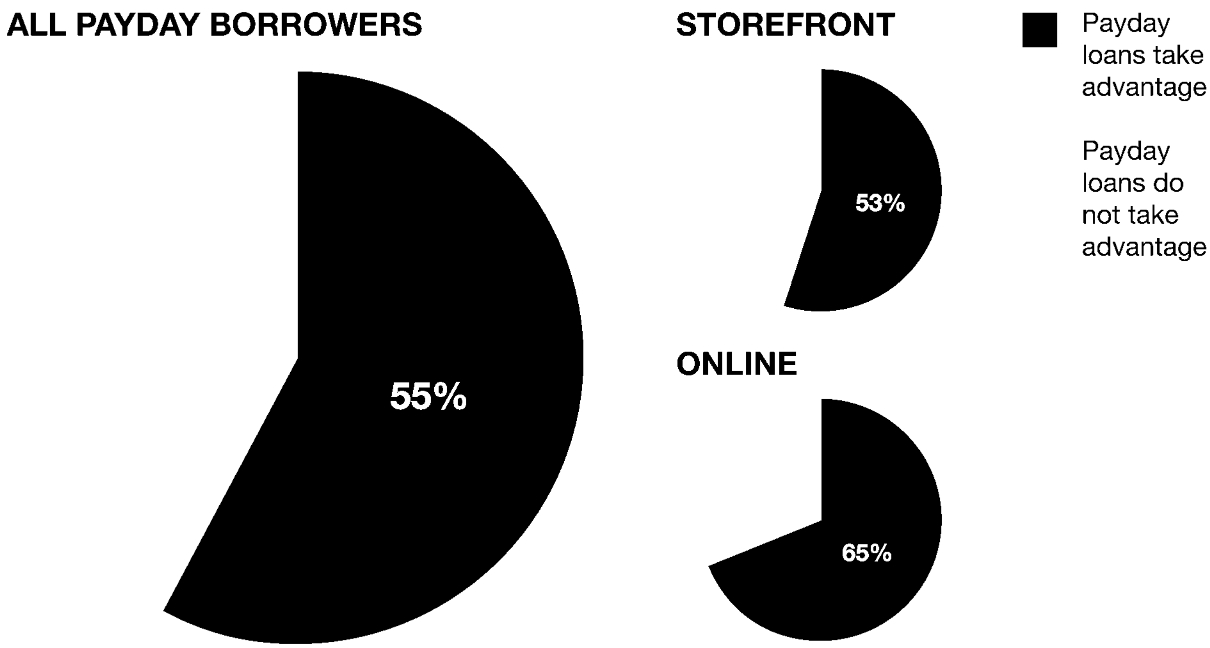
Similarly, 82 percent of those who found the loan terms and conditions "confusing" think the loans take advantage, compared with 51 percent of those who felt the terms and conditions were "clear."

However, 4 in 10 believe that the loans do not take advantage. In focus groups, borrowers who recounted more positive experiences often focused on the friendly relationships they have with individual employees at the payday loan stores they visit. Previous research has also found that storefront payday lenders win high marks for respectful and friendly customer service.[59]

The payday loan industry works hard to create a friendly and respectful atmosphere that customers appreciate. Many describe good relationships with those who work in the stores, even when the product leaves them indebted for an extended period of time.

EXHIBIT 15:

MAJORITY FEEL PAYDAY LOANS TAKE ADVANTAGE OF BORROWERS



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "Some people say (online payday loans/payday loans) take advantage of borrowers, while other people do not think (online payday loans/payday loans) take advantage of borrowers. What do you think, do (online payday loans/payday loans) take advantage of borrowers or not?" Data do not add to 100% because "Some of both/Neither," "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"So you feel like when, oh, when you go into a place like that, it's like Norm from 'Cheers.' … You're back. I mean, they're happy to see you, because you're a regular."

—Storefront borrower, Birmingham, AL

"They always … speak to you by first name and say, 'hello, how you doing' when you first come in the store, and are good with remembering your name and your face."

—Storefront borrower, Chicago

"But they're the same as you, the people that work there. … They're the same as you, they're just, they're struggling, too."

—Storefront borrower, Chicago

"It's like they're gouging people. … It's like they're just trying to take advantage of them in that situation."

—Storefront borrower, Birmingham, AL

Lenders tend not to compete on price, often all charging the same amount in a given market,[60] but they instead compete on customer service, seeking to maintain long-term relationships with borrowers. Payday loan advertisements promote "outstanding customer service,"[61] "fast, friendly service,"[62] "courteousness,"[63] "smiling,"[64] and "dedication to our customers."[65]

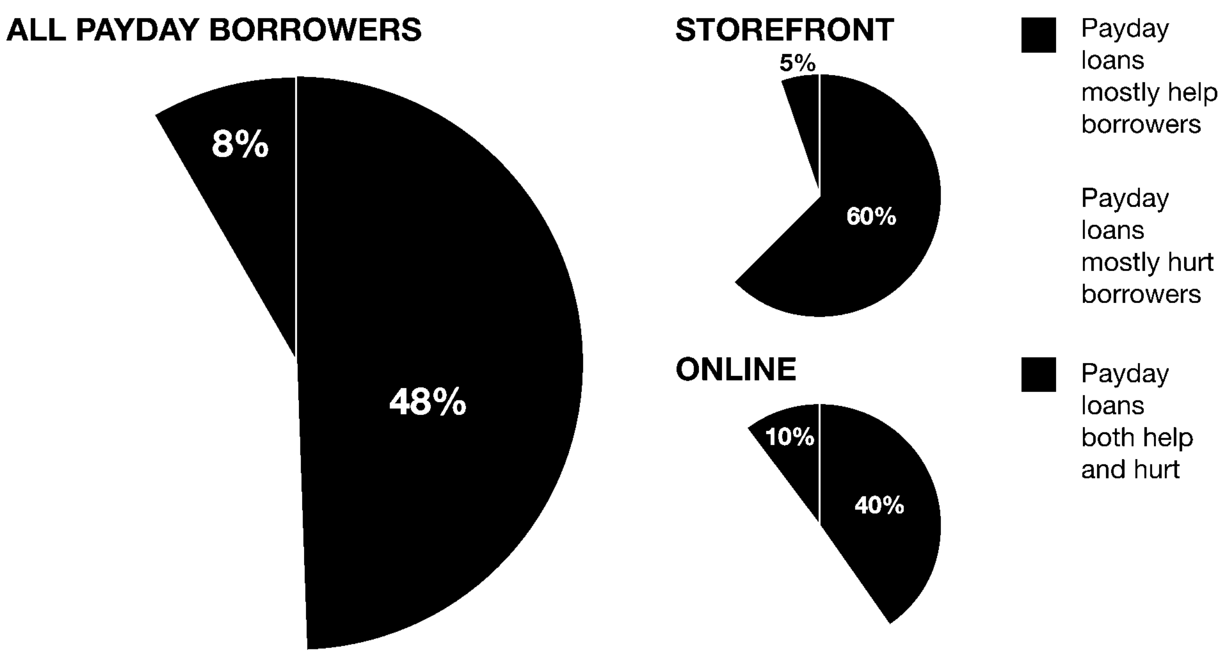
Borrowers Mixed on Whether Loans Help More Than Hurt

Borrowers are torn about whether payday loans mostly help or mostly hurt them, with slightly more saying that the loans help. In focus groups, most who talked about the loans being helpful spoke of the relief they felt when they were able to get a loan. In contrast, most of those who talked about the loans hurting concentrated on the difficulty of paying off the debt and the length of time it took to get out of a loan that had been advertised as lasting for two weeks.

These feelings also correspond to respondents' attitudes about their own financial situations, with those who have more frequent trouble meeting expenses more likely to say the loans hurt.

EXHIBIT 16:

SLIGHTLY MORE SAY LOANS HELP THAN HURT



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "Overall, do you think that (online payday loans/payday loans) MOSTLY help borrowers like you or MOSTLY hurt borrowers like you?" (IF "BOTH," ASK:) "I know it can be hard to say, but generally do you think they MOSTLY help or MOSTLY hurt borrowers?" "Payday loans both hurt and help" was a volunteered response and not read aloud. Data do not add to 100% because "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"So they're quick and they'll dish out the money to anybody, but do not rub that lamp the wrong way because you do not want to see that genie, forget it."

—*Online borrower, Manchester, NH*

"I just think that loan kind of, it didn't help. I mean, it helped, but it didn't in the long run."

—*Online borrower, New York*

"It was a short-term fix that I'm continually paying off."

—*Online borrower, Manchester, NH*

"I'm no better off than I was when I first applied, I'm actually worse off, because I'm deeper in debt than I was when I first started."

—*Online borrower, Manchester, NH*

HOW BORROWERS DESCRIBE PAYDAY LOANS

As a focus group exercise, borrowers were asked for a word or phrase to describe payday loans. They used more negative terms than positive ones, but some focused on the loan being helpful when they were in a tight spot.

Interestingly, most borrowers did not disagree with others who offered opposing terms. This exercise revealed borrowers' conflicted feelings, including appreciation for credit in a tough time while also feeling trapped by the difficulty of repaying the loan.

Among the descriptions respondents used are:

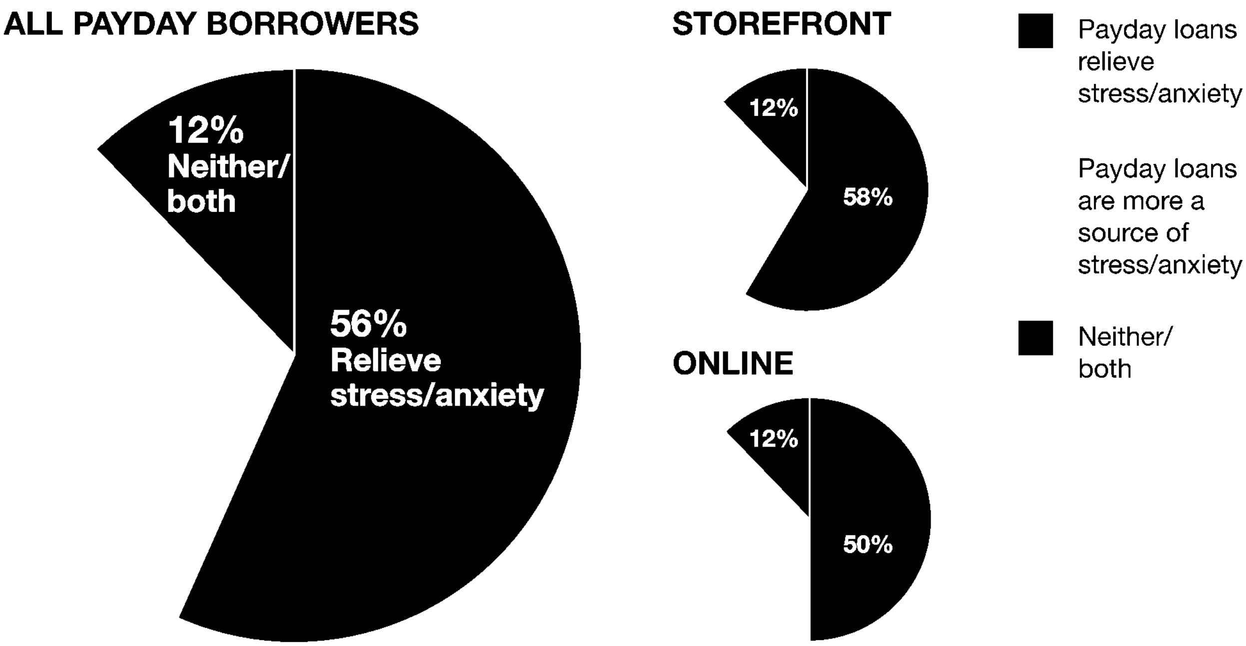
- Convenient
- Rip off
- Evil
- Never-ending
- Money hungry
- Lifesaver
- Should be abolished
- Takes advantage
- Emergency rescue
- Friendly
- Helpful
- Good in an emergency, but dangerous
- Predatory
- Sweet and Sour: Sweet when they give it to you, sour when you've got to pay it back
- Simple
- Desperate
- Helpful but very dangerous
- Tempting
- Expensive
- Panic
- Mistake
- Scary
- Too easy
- Accessible

More Say Loans Relieve Stress and Anxiety Than Cause It

More borrowers describe the loans as relieving—rather than causing—stress and anxiety, although online borrowers and those who report having trouble meeting their expenses more than half the time are more closely divided on this issue.

EXHIBIT 17:

MORE SAY LOANS RELIEVE STRESS AND ANXIETY THAN CAUSE IT



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "(Have/Was) the (online payday loan(s)/payday loan(s) (been) more a SOURCE of stress and anxiety or more something that has RELIEVED stress and anxiety?" "Neither/both" was a volunteered response and not read aloud. Data for storefront and all payday borrowers do not add to 100% because "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"It's good because it's there when you need it, but it's not good if you don't have the strategy down. You have to pay it back right away, and then if you can pay it back right away, why would you go and get it to begin with?"

—Storefront borrower, Chicago

"All I know is I got the money that I needed to pay the rent that I needed to pay. And so, you know, it's … a Catch-22."

—Online borrower, New York

"You pay it off, and then you panic because you know you have to go back, and you don't want to because you're going to lose the money, and you try to think of other options first, and if you don't have any, then you're right back in the same boat pretty much, panic, you know."

—Former storefront borrower, Manchester, NH

"That's where I go if I'm in a panic, the payday loans."

—Online borrower, Manchester, NH

PROFILES OF 'SATISFIED' CUSTOMERS

In a questionnaire as part of Pew's focus groups, the following borrowers all described themselves as "satisfied" with payday loans, as are most payday borrowers, according to industry surveys. To understand more thoroughly the experiences of these borrowers, and what it means to be satisfied with a payday loan, several quotes from each borrower are included below. Names have been changed to protect their privacy.

CHRISTINE (ALABAMA STOREFRONT BORROWER)

- Satisfaction level: "Very satisfied."
- Words to describe payday loans: "Emergency rescue."
- "I met a girl that worked at a payday loan store. Her kids go to school with my kids, and we were at a football game. And I had some medical bills that needed to be paid, and so I asked her about it. I always use her, and we've become friends, so, I mean, it's all pleasant."
- "I think they are fairly trustworthy. I mean, I think you have to use your own personal judgment about which one you use and the relationship you develop with the people there, because like you say, when you walk in, you deal with the same person every time. So in that aspect, it's trustworthy, but I also think they take advantage in the high interest rates."
- "So I went and got one for like $300. And I carried it for a couple of months … and then paid it off with the income tax refund."
- "I don't use it as a longer term, but, I mean, I've kept it for longer than two weeks. I mean, I kept one for two months. I've kept one for six months."

ROBERT (ILLINOIS STOREFRONT BORROWER)

- Satisfaction level: "Very satisfied."
- Words to describe payday loans: "Expensive, yeah. But convenient."
- "[It's] going to be that emergency help you need right now."
- "You can show them the paycheck, but they don't know what are you spending on your expenses outside of that money."
- "They closed my bank account that I had. I wasn't paying them back in full at the particular time, and I kept trying to delay them, and giving them partial payment, and they just went in, and they took their money. Which caused me to default, and I was behind in a lot of other areas, and I wasn't able to take care of that particular area."

PROFILES OF 'SATISFIED' CUSTOMERS

CORI (CALIFORNIA BANK DEPOSIT ADVANCE BORROWER)

- Satisfaction level: "Very satisfied."
- "It was the holidays and I just need some extra cash to get gifts and help out with Christmas dinner and do my part. It just seemed like a good option."
- "But then it started the cycle. Because once you do it once, then it takes that money out of your paycheck, and my paychecks were pretty well budgeted to the dollar, so once they take that money back out to pay off the advance, then I'm short again. So, then I have to do it again to keep up with my regular bills."
- "I got to the point that I couldn't do any more direct deposit advances, and I had to go to the [payday loan] store."
- "I paid back the payday lending store. My sister helped me do that and then she also helped me get caught up. Then once I was able to cash out my PTO (paid time off from work), I was able to pay her back and get myself on track. So I was living back within my biweekly paycheck means."

MATTHEW (NEW YORK ONLINE BORROWER)

- Satisfaction level: "Somewhat satisfied."
- Words to describe loans: "Expensive." "Helpful."
- "I don't want to go to my brother. I don't want to go to my sister, you know. And it's for me. I don't have to go talk to nobody. I just, online, boom."
- "I don't think it's the best way. It's not. But my options are limited."
- "So I wound up probably paying a fortune. … I think I took like $300. So they charged me every month, $30 on each $100. So you can pay $90 in three, four months, and you haven't even touched the principal yet. So that's why, again, I'm not going to cry over it because I knew the options and the choices, and they're what I made. But on the other hand, it's a pretty expensive way to get a few extra dollars."

7 Payday Customers Want Changes and More Regulation but Expect to Borrow Again if Loans are Available to Them

"I don't want to do it again. I don't want to, but I don't know, so I can't say I won't do it again because I might need to."

—Online borrower, New York

Borrowers' feelings about payday loans are somewhat complicated, but a general consensus emerges on three points:

(1) Borrowers want changes to how payday loans work.

(2) They want payday loans to be more regulated.

(3) Even if neither (1) nor (2) occurs, they will continue to use payday loans if they are in an especially difficult situation and the loans are available.

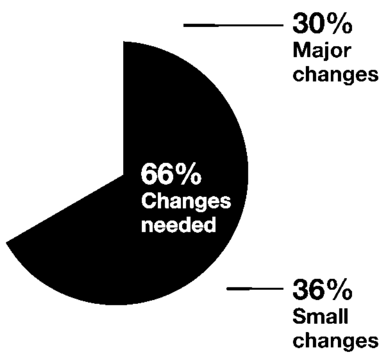
Although these findings provide only general feelings rather than specific solutions, they demonstrate that borrowers are not satisfied with the status quo and invite government oversight as part of the solution.

By a 2-1 Margin, Borrowers Want Changes to Payday Loans

Overall, borrowers are divided into three fairly even groups as to whether there should be major changes, small changes, or no changes to payday loans. Pew is conducting further research on the nature of changes that borrowers want to see.

EXHIBIT 18:

MOST WANT CHANGES TO PAYDAY LOANS



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "Which of the following best describes your view? 1. (Online payday loans/Payday loans) should be kept as they are now with no changes 2. There should be small changes to (online payday loans/payday loans) 3. There should be major changes to (online payday loans/payday loans)." Data do not add to 100% because "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

By an Almost 3-1 Margin, Borrowers Want More Regulation

Borrowers hold divergent views on many aspects of payday lending and its impact on them, but there is strong consensus for more regulation of payday loans across key payday borrower groupings, including:

Those who have trouble meeting their expenses, and those who do not.

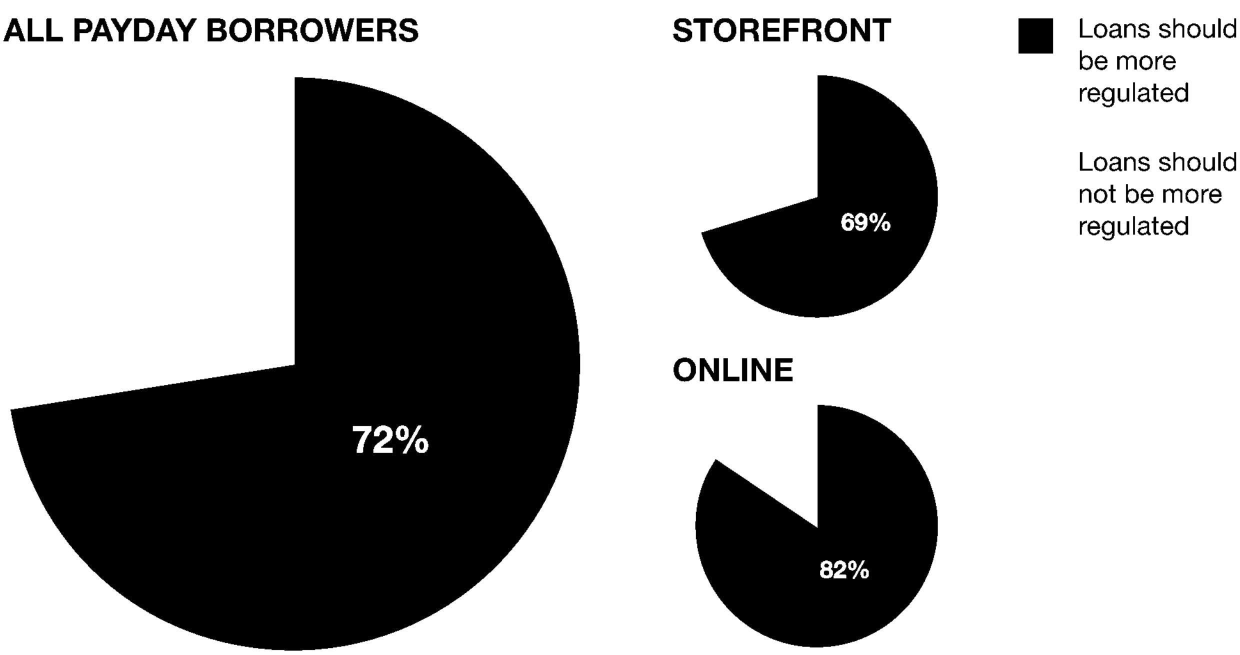
Those who describe their financial situation as good, and those who describe it as bad.

Those who say the loans mostly help, and those who say they mostly hurt.

Online borrowers are even more adamant than storefront borrowers, preferring greater regulation by a 5-1 margin.

EXHIBIT 19:

BORROWERS FAVOR MORE REGULATION



NOTE: Data represent percentage of payday borrowers who express the listed opinion. Respondents were asked: "Which of these statements comes closer to your point of view? 1. (Online payday loans/Payday loans) should be more regulated. 2. (Online payday loans/Payday loans) should not be more regulated." Data do not add to 100% because "Don't know" and "Refused" were omitted from this chart. Results are based on 703 interviews conducted from December 2011 through April 2012.

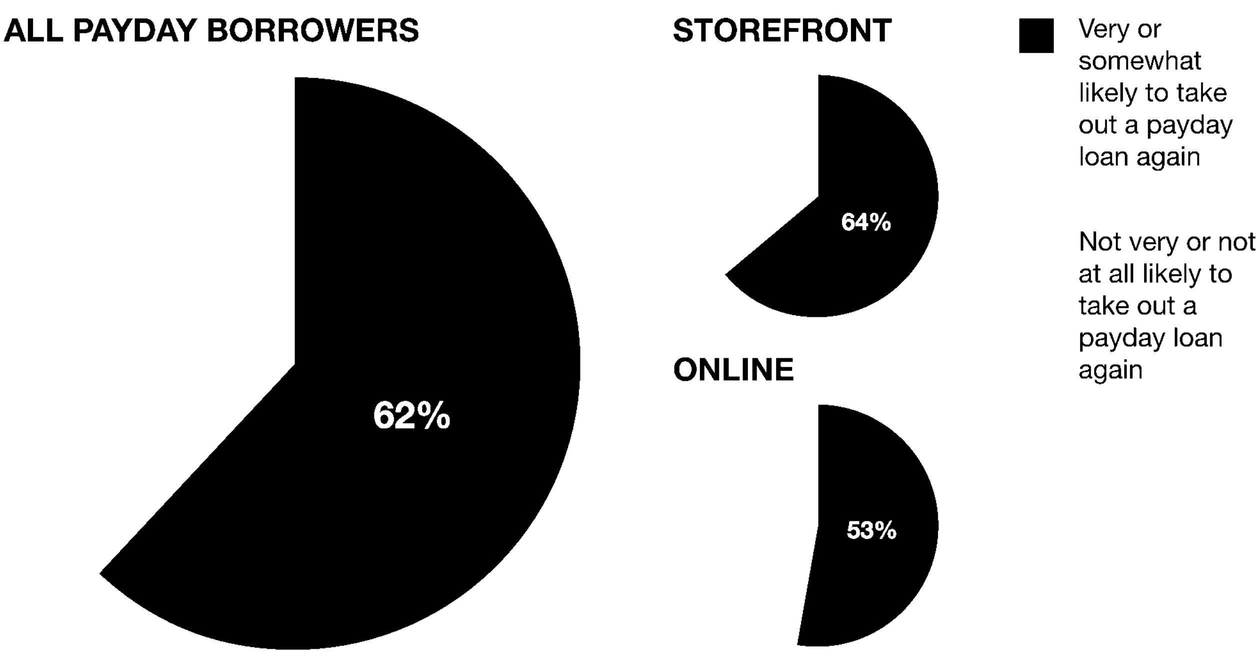
SOURCE: Pew's safe small-dollar loans research project, 2013.

3 in 5 Are Likely to Use Loans Again Regardless

Despite this desire for more regulation and changes to how payday loans work, 3 in 5 borrowers say they are likely to use the loans again if they are in a financial bind. Only one-fifth of borrowers say they are "not at all likely" to take out another loan. In focus groups, even borrowers who were unhappy that their payday loan debt had lasted much longer than expected thought they might use payday loans again with a better outcome. More storefront than online borrowers said they were likely to take out another payday loan. The tension between borrowers wanting changes and regulation, and the likelihood that they will use the loans again, is consistent with previous research that most borrowers would use the loans again, but few would do so without hesitation.[66]

EXHIBIT 20:

MAJORITY SAY THEY LIKELY WOULD TAKE ANOTHER PAYDAY LOAN



NOTE: Data represent percentage of payday borrowers who gave the listed answer. Respondents were asked: "If you find yourself in a financial bind again, how likely is it that you would take out (an online payday/a payday) loan?" Results are based on 703 interviews conducted from December 2011 through April 2012.

SOURCE: Pew's safe small-dollar loans research project, 2013.

"I still would rather go to them than my family, and so I feel like they need me, I need them at some point in time. You never know where you're going with this economy being the way it is. I think that they should redo, you know, their interest rates and their rules and all of that."

—Storefront borrower, Birmingham, AL

"If I had to get a loan out, I would go to one."

—Storefront borrower, Birmingham, AL

"When you need it, you've got to get it."

—Storefront borrower, Birmingham, AL

Some Are Relieved When Payday Stores Are Gone

Pew's research has shown that potential borrowers tend not to use payday loans when storefronts are not available in their communities. In states without payday stores, just 5 percent of would-be borrowers sought loans online or elsewhere, and the remaining 95 percent elected not to use payday loans at all.[67] Previous research conducted in North Carolina, where a state law eliminated payday loan stores, similarly found that people had not sought out payday loans elsewhere when the stores closed, and those who had previously borrowed from payday storefronts "were glad they no longer had the temptation."[68]

Participants in Pew's focus group of 10 former storefront borrowers in New Hampshire expressed similar feelings. Although payday stores once operated there, they are no longer available because of a change in state law.[69] Participants acknowledged that they had used the loans when they were in the state, but they had not gone online to borrow after the storefronts closed. Instead, these former borrowers mostly expressed relief, but some acknowledged they would probably use the stores if they returned to the state.

"I think they need to find other ways to help people out than just make it so easy to do that, because that's why people do it."

—*Former storefront borrower, Manchester, NH*

"I'm glad they're gone. I hope they never come back."

—*Former storefront borrower, Manchester, NH*

"[Now that payday lenders are gone] you can't get stuck in it."

—*Former storefront borrower, Manchester, NH*

"Just keep them out, we don't need them."

—*Former storefront borrower, Manchester, NH*

"Because there's too many little things to worry about now, you know. They're out, leave them out, and you know what I mean? Then you don't have to worry about it."

—*Former storefront borrower, Manchester, NH*

Conclusion

Understanding why people choose expensive credit products that they will have difficulty paying back, and how they eventually do pay them back, is vital for any effort to improve the utility and transparency of payday loans as well as other small-dollar credit products. One reason people choose payday loans, instead of cutting back on expenses or using informal options, is that they perceive the loans as affordable because lenders sell them as a short-term fix. The information provided describes just two weeks of indebtedness, although most borrowers end up having a loan out for far longer. Borrowers have conflicting desires—they want to receive a cash infusion but do not want to create ongoing debt—and a payday loan's short repayment term makes it seem as if both these desires can be met. The loan's unaffordable lump-sum repayment structure effectively means that borrowers pay only interest, so the principal is not reduced; this structure makes predicting the ultimate duration and cost of the loan extremely difficult.

The loan is packaged as a two-week product that is described as safe and preferable to costly options such as overdrafts. Borrowers tend to focus on the loan's advertised price, a fee they can afford, and not the impact that a lump-sum repayment will have on their monthly budget. The more than $400 required to repay an average loan is so incompatible with the $50 that the average payday customer can afford that the customer ends up re-borrowing repeatedly, paying a fee every two weeks to take the same money back out to cover basic expenses.

Proponents of payday lending tend to talk about overdrafts as the primary alternative to a payday loan; borrowers instead mostly describe their alternatives as taking on long-term debt, cutting back on expenses, or borrowing from family or friends. But even within this narrow range of options, it is nearly impossible to comparison shop, because a payday loan's ultimate cost and duration are vastly different from the stated loan terms.

The implication of a payday loan's unaffordability for most borrowers is that when people choose a payday loan instead of other options, they often end up turning to those very same options in order to pay back the payday loan. Among those who choose a payday loan, most overdraft their bank accounts anyway. Further, 27 percent of payday borrowers say a withdrawal by a payday lender has caused an overdraft, while others borrow from family or friends to pay off the loans, or use them long term. These findings indicate that many of the potential benefits—avoiding other debt, fees, or cutting back—do not materialize. Payday loans end up leaving borrowers in the same financial bind in which they started, despite having spent $520 annually on average.

This inconsistency is reflected in the sentiments of payday borrowers, who describe themselves as "satisfied" but are also deeply conflicted. They express relief upon receiving credit during a tough time, appreciation for friendly and respectful service, and say they might use payday loans again if they are in a difficult-enough situation. But they also state that the loans take advantage of them, need changes, and should be more regulated.

Federal regulators, including the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and especially the Consumer Financial Protection Bureau, have the authority to regulate the payday loan market. This ongoing series by The Pew Charitable Trusts, *Payday Lending in America*, presents in-depth findings to help identify the features of a safe and transparent marketplace for consumer financial services, to inform efforts to protect consumers from harmful practices, and to promote safe and transparent small-dollar credit.

Methodology

Opinion Research

Findings in this report are based on a survey conducted among storefront payday loan borrowers and online payday loan borrowers. The sample for this survey was compiled over the course of eight months of screening on a nationally representative weekly survey. Borrower quotations in this report come from a series of 10 focus groups with small-loan borrowers, as described below.

Survey Methodology

Social Science Research Solutions (SSRS) omnibus survey

The Pew Safe Small-Dollar Loans Research Project contracted with SSRS to conduct the first-ever nationally representative in-depth telephone survey with payday loan borrowers about their loan usage. To identify and survey a low-incidence population such as payday loan borrowers, SSRS screened 1,000 to 2,000 adults per week on its regular omnibus survey, using random-digit dialing (RDD) methodology, from August 2011 to April 2012. The term "omnibus" refers to a survey that includes questions on a variety of topics. This survey took steps to minimize payday loan borrowers' denial of their usage of this product, because the omnibus survey included mostly nonfinancial questions purchased by other clients, and the payday loan questions were asked after other, less sensitive questions, giving interviewers a chance to establish a rapport with respondents.

The first phase of the research, to identify payday borrowers, asked respondents to the omnibus survey whether they had used a payday loan. If respondents answered that they had, they were placed in a file to be re-contacted later. Once the full-length survey was ready to field, in order to maximize participation, people who had used a payday loan were then given the full-length survey and paid an incentive of $20 for participating. Because of their relative scarcity, online payday loan borrowers were given an incentive of $35 for participating.

Respondents were told about the compensation only after having indicated that they had used a payday loan. Further, online payday loan borrowers who were identified during the early months of screening were sent a letter with a $5 bill informing them that they would be re-contacted to take the full-length survey. The second phase of the research involved re-contacting all respondents who answered that they had used a payday loan and immediately giving the full-length survey to anyone newly identified in the weekly omnibus survey as a payday loan borrower.

Sample and Interviewing

In the first phase of the survey, the Pew Safe Small-Dollar Loans Research Project purchased time on SSRS's omnibus survey, EXCEL, which covers the continental United States. Analysis of the incidence of payday borrowing was conducted after 33,576 adults had been screened and answered a question about payday loan usage. An additional 16,108 adults were screened in order to find a sufficient number of storefront payday loan, online payday loan, and auto-title loan borrowers to complete a 20-minute survey about their usage and views, for a total of 49,684 screens to complete the research. The sampling error for those incidence estimates from the omnibus survey of borrowers is plus or minus 0.24 percentage points.

In the second phase, a total of 451 adults completed the full-length storefront payday loan survey, and 252 adults completed the full-length online payday loan survey, for a total of 703 payday borrowers. The sampling error for the full-length survey of payday borrowers is plus or minus 4.2 percentage points. The sampling error for the full-length survey of storefront payday loan borrowers is plus or minus 4.6 percentage points, and it is plus or minus 6.2 percentage points for the full-length survey of online payday loan borrowers.

EXCEL is a national weekly, dual-frame bilingual telephone survey. Each EXCEL survey consists of a minimum of 1,000 interviews, of which 300 interviews are completed with respondents on their cellphones and at least 30 are conducted in Spanish, ensuring unprecedented representation on an omnibus platform. Completed surveys are representative of the continental United States population of adults 18 and older. EXCEL uses a fully replicated, stratified, single-stage, random-digit-dialing (RDD) sample of land-line telephone households and randomly generated cellphones. Sample telephone numbers are computer-generated and loaded into online sample files accessed directly by the Computer-Assisted Telephone Interviewing (CATI) system. Within each sample household, a single respondent is randomly selected. Further details about EXCEL and its weighting are available at www.pewtrusts.org/small-loans. The proportion of storefront to online borrowers was weighted to the ratio at which they occurred naturally in the omnibus. Including 252 online borrowers reflects an oversample of 147 online borrowers, and the online borrower results have been weighted down accordingly so they would not have disproportionate influence over the full results.

Question Wording—Omnibus Survey

Wording for demographic and other questions is available at www.pewtrusts.org/small-loans.

Screening Phase (measuring incidence and compiling sample for callbacks):

- In the past five years, have you used payday loan or cash advance services, where you borrow money to be repaid out of your next paycheck?
- And was that physically through a store, or on the Internet?

Re-contact Phase (calling back respondents who answered affirmatively, and identifying additional borrowers to take the full-length survey immediately):

In the past five years, have you or has someone in your family used an in-person payday lending store or cash advance service?

Question Wording—Full-Length Survey of Storefront and Online Payday Loan Borrowers

The data from the nationally representative, full-length survey of 451 storefront payday loan borrowers and 252 online payday loan borrowers are based on responses to the following questions, which Pew designed with assistance from SSRS and Hart Research Associates. All other questions from this survey are being held for future release. The sample for this telephone survey was derived from the RDD omnibus survey. All questions also included “Don’t know” and “Refused” options that were not read aloud.

How would you rate the condition of your personal economic situation these days? Is it … (READ LIST)? (ENTER ONE RESPONSE)

1 Very good

2 Fairly good

3 Fairly bad

4 Very bad

How often, if ever, do you have trouble meeting your regular monthly bills and expenses—do you have trouble with this every month, most months, about half the time, less than half the time, or do you never have trouble meeting your regular monthly bills and expenses?

1 Every month
2 Most months
3 About half the time
4 Less than half the time
5 Never

Thinking back now to (that FIRST/the) time you took out (an online payday loan/a payday loan), which of the following best describes what specifically you needed the money for? (READ LIST. ACCEPT ONE RESPONSE.) (IF MORE THAN ONE, ASK:) Well, if you had to choose just one, which best describes what specifically you needed the money for?

1 To pay rent or a mortgage
2 To pay for food and groceries
3 To pay a regular expense, such as utilities, car payment, credit card bill, or prescription drugs
4 To pay an unexpected expense, such as a car repair or emergency medical expense
5 To pay for something special, such as a vacation, entertainment, or gifts
6 (DO NOT READ) Other (SPECIFY)

And was that primarily a personal or family expense, or was that primarily for a business that you own or operate?

(INTERVIEWER NOTE: If "BOTH," PROBE—) If you had to choose just one, would you say it was primarily for personal or for business reasons?

1 For personal or family reasons
2 For business I own or operate
3 (DO NOT READ) Both

When you took out (that FIRST/the) (online payday loan/payday loan), would you say the terms and conditions of the loan were very clear, somewhat clear, somewhat confusing, or very confusing?

1 Very clear
2 Somewhat clear
3 Somewhat confusing
4 Very confusing

Please tell me whether you have or have not used each of the following methods to pay back (an online payday loan/a payday loan). How about (INSERT)?

Have you used this method or not?

1 Have used

2 Have not used

a. Friends or family helped pay it off

b. Took out another short-term loan of any type to pay it off

c. Got a loan from a bank or credit union to pay it off

d. Had or saved enough money to pay it off

e. Used a tax refund to pay it off

f. Pawned or sold items to pay it off

g. Used a credit card to pay it off

Are you currently employed? (IF "NO," ASK:) Are you a student, a homemaker, retired, or unemployed?

1 Yes, employed

2 Student

3 Homemaker

4 Retired

5 Unemployed

6 (DO NOT READ) Volunteer

7 (DO NOT READ) Disabled

(ASK ONLY OF EMPLOYED STOREFRONT BORROWERS)

Are you self-employed or a small business owner, or not?

1 Yes, self-employed

2 No, not self-employed

3 (DO NOT READ) Both, self-employed/small business owner and work for someone else

How much can you afford to pay each MONTH toward (an online payday loan/a payday loan) and still be able to pay your other bills and expenses?

____________ ($0 to $1,000)

Overall, do you think that (online payday loans/payday loans) MOSTLY help borrowers like you or MOSTLY hurt borrowers like you? (IF "BOTH," ASK:) I know it can be hard to say, but generally do you think they MOSTLY help or MOSTLY hurt borrowers?

1 Mostly help

2 Mostly hurt

3 (DO NOT READ) Some of both/neither

(Have/Was) the (online payday loan(s)/payday loan(s)) (been) more a SOURCE of stress and anxiety or more something that has RELIEVED stress and anxiety?

1 More a source of stress and anxiety
2 More something that has relieved stress and anxiety
3 (DO NOT READ) Neither/both

I'm going to read you several options. For each, tell me whether you would use this option if you were short on cash, and short-term loans of any kind no longer existed. How about (INSERT)?

a. Borrow from family or friends
b. Borrow from your employer
c. Sell or pawn personal possessions
d. Delay paying some bills
e. Cut back on expenses such as food and clothing
f. Take out a loan from a bank or credit union
g. Use a credit card

Would you use this option or not?

1 Yes, would use
2 No, would not use

Which of the following best describes your view? (READ LIST. ACCEPT ONE RESPONSE.)

1 (Online payday loans/Payday loans) should be kept as they are now with no changes
2 There should be small changes to (online payday loans/payday loans)
3 There should be major changes to (online payday loans/payday loans)

(Asked of storefront borrowers only)

I'm going to read you several things that some people have told us happened to them. For each one I read, please tell me whether it has happened to you. How about had a payday lender attempt to make a withdrawal that overdrew your bank account? Has this happened to you or not?

1 Has happened
2 Has not happened
3 (DO NOT READ) Does not apply

(Asked of online borrowers only)

I'm going to read you several things that some people have told us happened to them. For each one I read, please tell me whether it has happened to you. How about had an online payday lender make a withdrawal that overdrew your bank account? Has this happened to you or not?

1 Has happened
2 Has not happened
3 (DO NOT READ) Does not apply

Which of these statements comes closer to your point of view?

(READ STATEMENTS)

1 (Online payday loans/Payday loans) should be more regulated
2 (Online payday loans/Payday loans) should not be more regulated

If you find yourself in a financial bind again, how likely is it that you would take out (an online payday loan/a payday loan)? Is it very likely, somewhat likely, not very likely, or not at all likely?

1 Very likely
2 Somewhat likely
3 Not very likely
4 Not at all likely

Have you ever felt you were in such a difficult situation that you would take (an online payday loan/a payday loan) on pretty much any terms offered, or have you never felt that way?

1 Yes, have felt that way
2 No, have not felt that way

How much do you rely on (online payday lenders/payday lenders) to give you accurate information—completely, somewhat, not much, or not at all? (ENTER ONE ONLY)

INTERVIEWER NOTE: ONLY READ IF RESPONDENT VOLUNTARILY ASKS A QUESTION SUCH AS, "WHAT KIND OF INFORMATION?" Say: "Information about the terms of the loan, including how much you pay in interest or fees, and when and how you will need to repay the loan."

1 Completely
2 Somewhat
3 Not much
4 Not at all

Some people say (online payday loans/payday loans) take advantage of borrowers, while other people do not think (online payday loans/payday loans) take advantage of borrowers. What do you think, do (online payday loans/payday loans) take advantage of borrowers or not?

1 (Online payday loans/payday loans) take advantage of borrowers
2 (Online payday loans/payday loans) do not take advantage of borrowers
3 (DO NOT READ) Some of both/neither

I'm going to read several types of financial products and services. For each one, please tell me whether you have used that product or service in the past year. Have you used (INSERT) in the past year?

1 Yes, used

2 No, have not used

a. A personal checking or savings account at a bank or credit union

b. A credit card

c. A prepaid card that works like a debit card but is not attached to an actual bank account

d. Overdrafting on your checking account (IF NECESSARY: Overdrafting is when your checking account balance becomes negative because more money has been withdrawn than was in the account)

(ASK ONLY OF THOSE WHO HAVE USED A CREDIT CARD IN THE PAST YEAR)

In the past year, have you maxed out or been at the top of your credit limit on any of your credit cards?

1 Yes, have maxed out

2 No, have not maxed out

(ASK ONLY OF THOSE WHO HAVE NOT USED A CREDIT CARD IN THE PAST YEAR)

Have you not used a credit card in the past year because you do not want one, because you think you would not be approved to get one, you are already making payments on one, or did you apply for one and were turned down? (ENTER ONE ONLY)

1 Do not want one

2 Would not be approved for one

3 Already making payments on one

4 Applied and was turned down

5 (DO NOT READ) Have credit card, but haven't used it in past year

6 (DO NOT READ) None of these

Focus Group Methodology

On behalf of the Safe Small-Dollar Loans Research Project, Hart Research Associates and Public Opinion Strategies conducted eight two-hour focus groups, with two groups per location in New York City; Chicago; Birmingham, AL; and Manchester, NH. Those groups were conducted during weekday evenings from Sept. 7, 2011, through Sept. 19, 2011. The Safe Small-Dollar Loans Research Project conducted two additional groups in San Francisco on Nov. 16, 2011. All quotations come from these 10 focus groups.

Endnotes

1 The Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), available at: http://www.pewstates.org/research/reports/who-borrows-where-they-borrow-and-why-85899405043.

2 CashNetUSA. https://www.cashnetusa.com/payday/articles/safe-secure-payday-loans-best-found-online.html.

3 Jamie Fulmer's presentation on behalf of the Consumer Financial Services Association available at: http://www.ncsl.org/portals/1/documents/fiscal/Jamie_Fulmer_PowerPoint.pdf.

4 Fisca website: http://www.fisca.org/Content/NavigationMenu/AboutFISCA/FAQs/default.htm.

5 See note 3, above.

6 The Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), p. 9.

7 These figures are from Pew's first report in this series, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012). The data for online borrowers have not been previously published.

8 Center for Financial Services Innovation. "A Complex Portrait—An Examination of Small-Dollar Credit Consumers." 2012. Available at: http://cfsinnovation.com/system/files/A%20Complex%20Portrait-%20An%20Examination%20of%20Small-Dollar%20Credit%20Consumers.pdf.

9 Industry analyst Stephens Inc. in its 2011 report estimates that borrowers do not become profitable for lenders until they have borrowed four or five times. Robert DeYoung and Ronnie J. Phillips of the Federal Reserve Bank of Kansas City Economic Research Department also conclude that "the profitability of payday lenders depends on repeat borrowing." http://www.kansascityfed.org/PUBLICAT/RESWKPAP/PDF/rwp09-07.pdf. An analysis of North Carolina data found that 73 percent of lender revenue came from borrowers using seven or more loans per year. Michael A. Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing," Economic Development Quarterly (2003), www.ccc.unc.edu/abstracts/0203_Payday.php. See also: The Pew Charitable Trusts, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), p. 15.

10 Pew's first report in this series, "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), found that borrowers are indebted for an average of five months, using eight loans (based on state regulatory data) that last 18.2 days (based on the Annual Report from Advance America, the largest storefront lender, which industry analysts use as a proxy for the storefront payday lending industry).

11 "Oklahoma Trends in Deferred Deposit Lending, 2011." 2011. http://www.ok.gov/okdocc/documents/2011_10_OK%20Trends_Final_Draft.pdf.

12 See note 11, above.

13 See note 9, above.

14 "Florida Trends in Deferred Presentment." 2010. https://www.veritecs.com/Docs/2010_06_FL_Trends-UPDATED.pdf. "Oklahoma Trends in Deferred Deposit Lending, 2011." 2011. http://www.ok.gov/okdocc/documents/2011_10_OK%20Trends_Final_Draft.pdf.

15 Leslie Parrish and Uriah King, "Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume." Center for Responsible Lending. June 2009. http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf.

16 In 2011, the average payday loan at the nation's largest payday lender—Advance America—was $375, based on its annual (10-K) report. Industry analyst Stephens Inc. uses Advance America as a proxy for the payday lending industry. Stephens Inc., "Payday Loan Industry" (2011). The average fee reported in Advance America's 10-K was $55, yielding a repayment of $430 in two weeks ($375+$55). Stephens also reports an average fee of $25 per $100 borrowed for online loans, implying a $95 fee for $375 borrowed, yielding a repayment of $470 in two weeks ($375+$95).

17 See note 10, above.

18 See note 14, above.

19 See note 6, above, p. 15.

20 See note 9, above. Most borrowing occurs in rapid succession (see note 15, above).

21 See note 11, above.

22 A trade group website includes a section titled "Is a Payday Advance Appropriate for You," which states, "A payday advance should be used responsibly and for only the purpose for which it is intended: To solve temporary cash-flow problems by bridging the gap between paydays. A payday advance is designed to provide short-term financial assistance. It is not meant to be a long-term solution." http://cfsaa.com/what-is-a-payday-advance/is-a-payday-advance-appropriate-for-you.aspx (accessed December 26, 2012).

23 Center for Financial Services Innovation. "A Complex Portrait—An Examination of Small-Dollar Credit Consumers." 2012. Available at: http://cfsinnovation.com/system/files/A%20Complex%20Portrait-%20An%20Examination%20of%20Small-Dollar%20Credit%20Consumers.pdf.

24 Oren Bar-Gill and Elizabeth Warren. "Making Credit Safer," (2008). Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1137981.

25 Examples include Marianne Bertrand, Sendhil Mullainathan, and Eldar Shafir. "Behavioral Economics and Marketing in Aid of Decision-Making among the Poor," (2006); Stephen J. Hoch. "Counterfactual Reasoning and Accuracy in Predicting Personal Events," (1984); and Ron Harris and Einat Albin. "Bankruptcy Policy in Light of Manipulation in Credit Advertising." (2006).

26 Raymond S. Nickerson. "Confirmation Bias: A Ubiquitous Phenomenon in Many Guises." (1998). Available at: http://psy2.ucsd.edu/~mckenzie/nickersonConfirmationBias.pdf.

27 U.S. Bank printed advertisement, September 2012. On file at The Pew Charitable Trusts.

28 U.S. Bank printed advertisement, September 2012. On file at The Pew Charitable Trusts.

29 Advance America. http://www.advanceamerica.net/community-outreach/witfy.

30 Advance America printed advertisement. "People are Saving by Dining In." On file at The Pew Charitable Trusts.

31 CashNetUSA. http://www.cashnetusa.com/fast-cash/fast-cash-payday-loan.html.

32 Quik Cash printed advertisement. September 2012. On File at The Pew Charitable Trusts.

33 We Loan Cash. www.weloancash.net.

34 Reliable Finance printed advertisement. September 2012. On file at The Pew Charitable Trusts.

35 Washington State Department of Financial Institutions. 2011 Payday Lending Report. http://www.dfi.wa.gov/cs/pdf/2011-payday-lending-report.pdf.

36 For example, a $500 loan in Washington carries a $75 fee, so the default loan structure would require a $575.00 payment, while the installment structure would provide for up to 12 payments of $47.92 each over 180 days.

37 Details governing Washington's installment options on payday loans are available at http://apps.leg.wa.gov/Rcw/default.aspx?cite=31.45.084.

38 See note 35, above.

39 This calculation is made by dividing the 40,367 loans that were paid in full within a month by the 297,985 loans that were made. Data are available at: http://www.coloradoattorneygeneral.gov/sites/default/files/uploads/uccc/annual_reports/2011%20DDL%20Composite.REV_.pdf.

40 For example, Raj Chetty et al. classify 85 percent of people as "passive savers" who are heavily influenced by defaults as to whether to use a retirement savings account, but not by tax incentives to save. "Active vs. Passive Decisions and Crowdout in Retirement Savings Accounts: Evidence from Denmark." 2012. According to John Beshears et al., "recent research has highlighted the important role that defaults play in a wide range of settings: organ donation decisions (Johnson and Goldstein 2003; Abadie and Gay 2004), car insurance plan choices (Johnson et al. 1993), car option purchases (Park, Jun, and McInnis 2000), and consent to receive e-mail marketing (Johnson, Bellman, and Lohse 2003)." Beshears et al. find that defaults have "tremendous influence" on "savings plan participation, contributions, asset allocation, rollovers, and decumulation." "The Importance of Default Options for Retirement Savings Outcomes," published in Social Security Policy in a Changing Environment. 2009.

41 Gregory Elliehausen and Edward C. Lawrence. "Payday Advance Credit in America: An Analysis of Customer Demand." (2001). Marianne Bertrand and Adair Morse. "Information Disclosure, Cognitive Biases and Payday Borrowing." (2010).

42 The Pew Charitable Trusts. "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012).

43 National Consumer Law Center. "300% Bank Payday Loans Spreading." http://www.nclc.org/images/pdf/banking_and_payment_systems/ib_bank_payday_spreading.pdf.

44 CashNetUSA. http://www.cashnetusa.com/payday/articles/use-payday-loans-to-stop-a-bank-overdraft-or-nsf-fee.html. (2012).

45 MoneyMutual. www.moneymutual.com. (2012).

46 These results refer to those borrowers who have had an account at a bank or credit union in the past year. Because these are questions about extended periods of time, it is impossible to say whether borrowers were overdrafting at the same times they were using payday loans, but the underlying point remains valid that payday loans do not eliminate overdraft risk.

47 It should be noted that bank customers can avoid overdraft fees on debit card transactions and ATM withdrawals by not opting in to overdraft coverage when they open an account, or by opting out at a later point. But a study by Pew's safe checking in the electronic age project, "Overdraft America: Confusion and Concerns about Bank Practices" (2012), found that a majority of customers who had paid an overdraft penalty fee in the last year did not realize that they had opted in to these fees.

48 Cypress Research Group. "Payday Advance Customer Satisfaction Survey." 2004. Available at: http://www.rtoonline.com/images/Payday-Loan-National-Customer-Satisfaction-Survey.pdf.

49 FiServ brochure. "Relationship Advance." 2009. On file at The Pew Charitable Trusts.

50 Dennis Campbell, Francisco de Asis Martinez-Jerez, and Peter Tufano. "Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures." 2008. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873.

51 Donald P. Morgan and Michael R. Strain. "Payday Holiday: How Households Fare after Payday Credit Bans." 2007. Available at: http://www.newyorkfed.org/research/staff_reports/sr309.pdf.

52 Bretton Woods Inc. 2008 Fee Analysis of Bank and Credit Union Non-Sufficient Funds and Overdraft Protection Programs. 2009. Available at: http://bretton-woods.com/media/Bretton$20Woods$2C$20Inc.$202008$20NSF-ODP$20Fee$20Analysis$2C$2001-09-2009.pdf Analysis by Center for Responsible Lending. "Payday Loans Put Families in the Red." 2009. Available at: http://www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf.

53 The Pew Charitable Trusts. "Overdraft America: Confusion and Concerns about Bank Practices." (2012) http://www.pewhealth.org/uploadedFiles/PHG/Content_Level_Pages/Issue_Briefs/SC-IB-Overdraft%20America.pdf.

54 The exact wording for this question was different for storefront and online borrowers because of an oversight and is reported verbatim in the methodology section.

55 The Pew Charitable Trusts. "Payday Lending in America: Who Borrows, Where They Borrow, and Why." (2012).

56 The other options that payday borrowers say they would have available to them if payday loans were unavailable are discussed in more detail in the first report in this series, "Payday Lending in America: Who Borrows, Where They Borrow, and Why." (2012).

57 Marianne Bertrand and Adair Morse. "What Do High-Interest Borrowers Do With Their Tax Rebate?" (2009). Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1344489.

58 Center for Responsible Lending's analysis of how a payday loan would fit into a typical borrower's household budget reached a similar conclusion. "Springing The Debt Trap." (2007). Available at: http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf.

59 See note 48, above.

60 Robert B. Avery and Katherine A. Samolyk, "Payday Loans Versus Pawn Shops: The Effects of Loan Fee Limits on Household Use." (preliminary draft, 2011).

61 ACE Cash Express. https://www.acecashexpress.com/services.

62 Dollar Financial Group. http://www.dfg.com/mobile/products.asp.

63 Check into Cash. http://checkintocash.com/Testimonials/.

64 Check into Cash. http://checkintocash.com/Testimonials/.

65 Dollar Loan Center DBA www.dontbebroke.com; Quik Cash. Printed advertisement, downloaded September 2012.

66 Center for Financial Services Innovation. "A Complex Portrait." 2012. Forty-four percent of payday borrowers would use the loans again only if they have no better options, 33 percent would use the product again without hesitation, and 22 percent would not use payday loans again.

67 Pew's first report in this series found that in states that restrict storefront lending, 95 out of 100 would-be borrowers elect not to use payday loans at all—just five borrow online or elsewhere. "Payday Lending in America: Who Borrows, Where They Borrow, and Why" (2012), pps. 22-23.

68 Jannekke Ratcliffe and Kim Manturuk. "North Carolina Consumers after Payday Lending: Attitudes and Experiences with Credit Options" UNC Center for Community Capital. (2007). Available at: http://www.nccob.gov/public/docs/News/Press%20Releases/Archives/2007/NC_After_Payday.pdf.

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Exhibit D

Comments to the
Federal Deposit Insurance Corporation
and
Office of the Comptroller of the Currency, Treasury

Proposed Guidance on Deposit Advance Products
FDIC: 78 Federal Register 25268 (April 30, 2013)
OCC: 78 Federal Register 25353 (April 30, 2013); Docket ID OCC 2013-0005

by

AARP[1]
Center for Responsible Lending[2]
Consumer Federation of America[3]
Leadership Conference on Civil and Human Rights[4]
NAACP[5]
National Consumer Law Center (on behalf of its low income clients)[6]
National Council of La Raza[7]

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[1] **AARP** is a nonprofit, nonpartisan organization, with a membership of more than 37 million, that helps people turn their goals and dreams into real possibilities, strengthens communities and fights for the issues that matter most to families such as healthcare, employment and income security, retirement planning, affordable utilities and protection from financial abuse.

[2] **The Center for Responsible Lending** (CRL) is a not-for-profit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, which consists of a state-chartered credit union (Self-Help Credit Union (SHCU)), a federally-chartered credit union (Self-Help Federal Credit Union (SHFCU)), and a non-profit loan fund. SHCU has operated a North Carolina-chartered credit union since the early 1980s. Beginning in 2004, SHCU began merging with community credit unions that offer a full range of retail products. In 2008, Self-Help founded SHFCU to expand Self-Help's mission.

[3] **Consumer Federation of America** is an association of nearly 300 non-profit consumer organizations that was established in 1968 to advance the consumer interest through research, education and advocacy.

[4] **The Leadership Conference on Civil and Human Rights** is a coalition charged by its diverse membership of more than 200 national organizations to promote and protect the civil and human rights of all persons in the United States. Through advocacy and outreach to targeted constituencies, The Leadership Conference works toward the goal of a more open and just society – an America as good as its ideals. The Leadership Conference is a 501(c)(4) organization that engages in legislative advocacy. It was founded in 1950 and has coordinated national lobbying efforts on behalf of every major civil rights law since 1957.

[5] **The NAACP**, founded in 1909, is the nation's oldest and largest civil rights organization. From the ballot box to the classroom, the thousands of dedicated workers, organizers, leaders and members who make up the NAACP continue to fight for social justice for all Americans.

[6] Since 1969, the nonprofit **National Consumer Law Center®** (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

[7] **The National Council of La Raza** (NCLR)—the largest national Hispanic civil rights and advocacy organization in the United States—works to improve opportunities for Hispanic Americans. Through its network of nearly 300

I. Introduction

We write to thank the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) (collectively, the Agencies) for the proposed guidance addressing bank payday lending,[8] particularly the underwriting requirements and limits on repeat loans. These critical provisions address a central problem with payday lending: lenders' failure to verify the borrower's ability to repay the loan, and meet other expenses, without reborrowing, leading to a destructive cycle of repeat loans that trap borrowers in long-term debt.

This proposed guidance is urgently needed. The great majority of banks do not offer payday loans, but we are aware of at least six that do. Four are supervised by the OCC: Wells Fargo Bank, U.S. Bank, Bank of Oklahoma and its bank affiliates,[9] and Guaranty Bank. Two are supervised by the Federal Reserve Board (FRB): Fifth Third Bank and Regions Bank.

Though the number of banks making payday loans remains small, there are clear signals that bank payday lending will grow rapidly without strong action by all the banking regulators. In mid-2011, Fiserv, Inc., a provider of bank payday software, reported that its "pipeline" was "extremely strong" and that it had "some very nice mid-tier signings."[10] Fiserv was promising that a bank's revenue from the product would be "greater than all ancillary fee revenue combined" within two years.[11]

But recent research has left no doubt that fees generated by bank payday loans are earned through unsafe and unsound banking practices and at great consumer harm to consumers. Bank payday lenders, like other payday lenders, do not assess the borrower's ability to repay the loan, and meet other expenses, without reborrowing, resulting in a cycle of repeat loans: The Consumer Financial Protection Bureau (CFPB)'s analysis of thousands of bank payday loans

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affiliated community-based organizations, NCLR reaches millions of Hispanics each year in 41 states, Puerto Rico, and the District of Columbia. To achieve its mission, NCLR conducts applied research, policy analysis, and advocacy, providing a Latino perspective in five key areas—assets/investments, civil rights/immigration, education, employment and economic status, and health. In addition, it provides capacity-building assistance to its Affiliates who work at the state and local level to advance opportunities for individuals and families. Founded in 1968, NCLR is a private, nonprofit, nonpartisan, tax-exempt organization headquartered in Washington, DC, serving all Hispanic subgroups in all regions of the country. It has regional offices in Chicago, Los Angeles, New York, Phoenix, and San Antonio and state operations throughout the nation.

[8] Federal Deposit Insurance Corporation, Proposed Guidance on Deposit Advance Products, 78 Fed. Reg. 25268 (April 30, 2013); Department of the Treasury—Office of the Comptroller of the Currency, Proposed Guidance on Deposit Advance Products; Withdrawal of Proposed Guidance on Deposit-Related Consumer Credit Products, 78 Fed. Reg. 25353 (April 30, 2013).

[9] Bank of Albuquerque, Bank of Arizona, Bank of Arkansas, Bank of Kansas City, Bank of Texas, and Colorado State Bank and Trust.

[10] Fiserv Investor conference webcast, October 11, 2011, *available at* http://investors.fiserv.com/events.cfm.

[11] Fiserv, Relationship Advance program description, *retrieved from* http://www.relationshipadvance.com/ in August 2011, on file with the Center for Responsible Lending.

found that banks put borrowers into an average of 14 loans annually and keep them indebted for a significant portion of the year.[12] Fourteen percent of borrowers took out an average of 38 loans averaging $200 each in one year, paying from $570 to $760 in interest.[13]

The fundamental structure of payday loans—a very high cost and short loan term with a balloon repayment—coupled with a lack of traditional underwriting makes repeat loans highly likely. Borrowers already struggling with regular expenses or facing an emergency expense with minimal savings are typically unable to repay the entire lump-sum loan and fees and meet ongoing expenses until their next payday. Consequently, the borrower often must take out another loan before the end of the pay period to meet other expenses, becoming trapped in a cycle of repeat loans.

We appreciate the Agencies' explicit recognition of the "shared characteristics" of bank payday lending and traditional payday lending and note that it is appropriate that this proposed guidance is intended to supplement the Agencies' existing guidances addressing payday lending.[14]

Failure to verify the borrower's ability to repay the loan poses clear safety and soundness risk to banks, as supported by a wide range of regulatory precedent. It is inconsistent with fundamental safe and sound lending practices; it exposes banks to legal risk, including, as the Agencies highlight, risk of violating provisions prohibiting unfair, deceptive, and abusive practices and the Equal Credit Opportunity Act; and it poses reputational risk, as evidenced by widespread opposition to bank payday lending.

Bank payday lending poses these risks in part because it causes severe harm to banks' customers. Research has long shown that payday loans cause serious financial harm to borrowers, including increased likelihood of bankruptcy, paying credit card debts and other bills late, delayed medical care, and loss of basic banking privileges because of repeated overdrafts.

Senior Americans receiving Social Security benefits make up over a quarter of bank payday borrowers. At a time when older Americans have already experienced severe declines in wealth resulting from the Great Recession, banks take these borrowers' benefits for repayment before they can use those funds for healthcare, prescription medicines, or other critical expenses. The threat bank payday loans pose to Social Security recipients became more pronounced March 1 of this year, when electronic distribution of government benefits became mandatory.

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[12] Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* at 34, April 24, 2013, *available at* http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf [hereinafter CFPB Findings].

[13] The CFPB found that for the 14% of borrowers who borrowed over $9,000 in one year, the median number of loans was 38 and the median size was $200. *Id.* at 34. We computed the total interest paid as $570 to $760, assuming a fee range of $7.50 per $100 borrowed to $10 per $100 borrowed based on the fees currently charged by banks making payday loans.

[14] FDIC: 78 Fed. Reg. 25268-70; OCC: 78 Fed. Reg. 25353-54.

Payday lending also has a particularly adverse impact on African Americans and Latinos, as a disproportionate share of payday borrowers come from communities of color, who are already overrepresented among unbanked and underbanked households.

Preventing the cycle of debt and its resulting harms is essential. Thus, we strongly support the Agencies' proposed underwriting and related requirements in combination, including (1) requiring that banks verify the borrower's ability to repay the loan and meet expenses without reborrowing based on an analysis of the customer's inflows and outflows, and (2) limiting the number of bank payday loans banks can extend to each customer.

Other pernicious elements of bank payday lending are its cost and the bank's repaying itself first directly from the borrower's next deposit. Bank payday loans average 225% to 300% annual percentage rate (APR)—extraordinary by any measure. The Agencies' proposal underscores that fees must be based on safe and sound banking principles; clearly, these loans' current fees are not. We urge the Agencies to clarify that safe and sound banking principles require that interest and fees be reasonable and, consistent with the FDIC's affordable small loan guidelines, should not exceed 36% APR, subject to more restrictive state laws. We also urge the Agencies to prohibit banks from requiring that the loans be automatically repaid from incoming deposits as a condition of making a loan, which denies borrowers control of their checking account and discourages sound underwriting.

In the last two years, we are aware of no additional banks entering the high-cost payday lending market. This is thanks in large part to the Agencies' refusal to condone this product: the OCC's not finalizing its 2011 proposed guidance,[15] the OCC's 2012 testimony before the House of Representatives calling payday loans "unsafe and unsound and unfair to consumers" and noting that profitability "is dependent on effectively trapping consumers in a cycle of repeat credit transactions, high fees, and unsustainable debt";[16] and the FDIC's 2012 announcement of its investigation into bank payday lending and longstanding leadership on responsible small dollar lending.[17]

Today, by proposing guidance explicitly requiring verification of ability to repay without reborrowing, the Agencies are bringing much-needed clarity to the marketplace for the banks

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[15] The undersigned groups were among those who urged the OCC to withdraw its 2011 proposed guidance (76 Fed. Reg. 33409, June 8, 2011) out of concern that it would have resulted in additional banks beginning to make payday loans. Concurrent with the issuance of the current proposed guidance, the OCC withdrew the previous proposed guidance. 78 Fed. Reg. 25353.

[16] Testimony of Grovetta Gardineer, Deputy Comptroller for Compliance Policy, Office of the Comptroller of the Currency, Before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, July 24, 2012, at 1, 5.

[17] Letter from FDIC to Americans for Financial Reform, May 29, 2012, *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Bank-DDA-FDIC-OC12-65R-1.pdf, also noting that the FDIC was "deeply concerned" about payday lending by banks.

they supervise while protecting the safety and soundness of those institutions and the consumers who bank with them.

Recommendations

With respect to the Agencies' proposal, we recommend the following:

- Preserve the proposed underwriting and related requirements *in combination*, including:
    - o requiring that banks determine the borrower's ability to repay the loan without reborrowing, based on an analysis of the customer's inflows and outflows; and
    - o limiting the number of bank payday loans.
- Clarify that safe and sound banking principles require that interest and fees be reasonable; consistent with the FDIC's affordable small loan guidelines, cost should equate to no more than 36 percent in annualized interest rate terms, subject to more restrictive state laws.
- Advise that banks not impose mandatory automatic repayment, particularly when repayment is triggered by the borrower's next deposit.
- Conduct prompt and vigilant examination of banks' compliance with the guidance and take swift enforcement action to address any noncompliance.
- Work with the CFPB to encourage improvements to existing consumer regulations, including the annual percentage rate (APR) disclosure under the Truth in Lending Act (TILA) and protections against mandatory automatic repayment under the Electronic Fund Transfer Act (EFTA).

II. Ability to repay is a fundamental principle of sound lending that payday lenders, including banks making payday loans, are violating.

A. Payday loans are made without regard to the borrower's ability to repay the loan, leading to a cycle of debt.

Payday loans are made without regard to the borrower's ability to repay the loan.[18] The lender instead relies on its ability to seize the borrower's incoming direct deposit, which serves as

[18] As the Agencies note, the decision to make a bank payday loan is "based solely on the amount and frequency of their deposits," standing "in contrast to banks' traditional underwriting standards . . . which typically include an analysis of the borrower's finances." FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354. The CFPB also recently recognized that payday loans involve "very limited underwriting." CFPB Findings at 6.

collateral.[19] It would be inaccurate to conclude that lenders do assess ability to repay because they typically have the ability to collect the loan proceeds from the borrower's direct deposit. As discussed below, regulatory precedent makes clear that lending with regard to ability to repay means determining the borrower can repay the loan *from sources other than the collateral*; in the payday loan context, that means that the borrower can *both* repay the loan *and* meet other obligations *without reborrowing*. Thus, repeat loans are evidence of disregard for ability to repay.

1. Repeat loans are evidence of disregard for ability to repay.

The Agencies note that "[d]eposit advance loans that have been accessed repeatedly or for extended periods of time are evidence of 'churning' and inadequate underwriting."[20] The CFPB's recent analysis notes that "a pattern of sustained use may indicate that a borrower is using payday loans to deal with expenses that regularly outstrip their income."[21]

The banking regulators have long recognized that serial refinancings are an indication that lenders are not assessing a borrower's ability to repay the loan, both in the context of payday lending specifically and more broadly. The FDIC's existing payday loan guidelines, which this proposed guidance supplements, describe concerns with "payday loans to individuals who do not have the ability to repay, or that may result in repeated renewals or extensions and fee payments over a relatively short span of weeks." The FRB's 2009 rules under the Home Ownership and Equity Protection Act (HOEPA) note that "[l]ending without regard to repayment ability . . . facilitates an abusive strategy of 'flipping' borrowers in a succession of refinancings."[22]

The banking regulators have also long recognized that a payday loan taken out within a short time of repaying another one is the economic equivalent of a refinancing (where the borrower uses the proceeds from a new loan to pay off an existing loan) or a rollover (where the borrower pays the finance charge essentially to extend the loan term).

The FDIC's 2005 payday loan guidelines note that "[w]here the economic substance of consecutive advances is substantially similar to 'rollovers' - without appropriate intervening 'cooling off' or waiting periods - examiners should treat these loans as continuous advances . . . ."[23] The OCC's 2000 payday loan guidelines note that payday loans are repaid when the

[19] FDIC: 78 Fed. Reg. 25272, n.22; OCC: 78 Fed. Reg. 25356, n.22 (citing 2001 Interagency Subprime Guidance noting that lenders should determine ability to repay from sources other than the collateral pledged, "in this case the borrower's direct deposit").

[20] FDIC: 78 Fed. Reg. 25272; OCC: 78 Fed. Reg. 25356.

[21] CFPB Findings at 24.

[22] Federal Reserve System, Truth in Lending, Regulation Z; Final Rule, 73 Fed. Reg. 44522, 44542 (July 30, 2008).

[23] FDIC Financial Institution Letters, Guidelines for Payday Lending, FIL 14-2005, February 2005, *available at* http://www.fdic.gov/news/news/financial/2005/fil1405a.html.

borrower "'roll[s] over' the loan by renewing the old loan (or taking out another loan)," essentially equating the two.[24] The CFPB's supervision manual for small dollar, short-term loans explains that back-to-back transactions may occur where a borrower is asked to repay one loan before opening a new loan, while noting that a pattern of these, like rollovers and refinancings, "may constitute sustained use."[25] And the CFPB's white paper defines "sustained use" in terms of loans that occur the same day a previous loan was closed "*or soon after*."[26]

The regulators have also typically contrasted loans made based on the value of the underlying collateral (and that are thus frequently refinanced) with loans made with regard to a borrower's ability to repay the loan, indicating that these practices are mutually exclusive. The 2001 Interagency Expanded Guidance on Subprime Lending Programs (2001 Interagency Subprime Guidance), which the current proposal supplements, describes that abusive lending practices occur when "the lender structures a loan to a borrower who has little or no ability to repay the loan from sources other than the collateral pledged."[27] As the Agencies note in the current proposal, in the case of bank payday lending, the collateral is the customer's incoming deposit.[28] The OCC's 2000 letter on abusive lending practices, which is applicable to payday loans,[29] discusses collateral or equity stripping as "reliance on . . . collateral, *rather than* the borrower's independent ability to repay. . . ."[30] The OCC's 2003 letter on abusive and predatory lending does the same.[31]

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[24] OCC Advisory Letter, Payday Lending, AL 2000-10 (Nov. 27, 2000), *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-10.pdf [hereinafter OCC 2000 Advisory Letter on Payday Lending].

[25] CFPB Supervision and Examination Manual, Small-Dollar, Short-Term Lending, Version 2 (October 2012), , at 12.

[26] CFPB Findings at 24.

[27] Interagency Expanded Guidance or Subprime Lending Programs, FIL 9-2001, January 31, 2001. The FDIC's 2005 payday loan guidelines also notes that it clarifies previously issued guidance, including the 2001 Expanded Subprime Guidance; the 2001 Expanded Subprime Guidance also contemplates equity stripping outside the context of mortgage lending, noting that lenders may make a loan to a borrower who has little or no ability to repay other than from the collateral pledged, then take possession of the borrower's home or automobile upon default.

[28] FDIC: 78 Fed. Reg. 25272, n.21; OCC: 78 Fed. Reg. 25357, n.21.

[29] The OCC's 2000 Advisory Letter on Payday Lending states that the OCC's 2000 Advisory Letter on Abusive Lending Practices is applicable to payday lending.

[30] OCC Advisory Letter on Abusive Lending Practices, AL 2000-7 (June 25, 2000), *available at* http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-7.pdf (emphasis added).

[31] OCC Advisory Letter, Guidelines for National Banks to Guard Against Predatory and Abusive Lending Practices, AL 2003-2 (Feb. 21, 2003), *available at* http://www.occ.gov/static/news-issuances/news-releases/2003/nr-occ-2003-8-advisory-ltr-2003-2.pdf [hereinafter OCC 2003 Letter on Predatory and Abusive Lending Practices]: "When a loan has been made based on the foreclosure value of the collateral, rather than on a determination that the borrower has the capacity to make the scheduled payments under the terms of the loan, based on the borrower's current and expected income, current

Thus, there is ample precedent for concluding that reliance on collateral, and the repeat loans such reliance generates, is a clear evidence of inability to repay.

2. The data on bank payday lending make clear repeat loans are typical.

The data on bank payday loans make clear that repeat loans, or "churning," are typical, confirming that lenders are not verifying borrowers' ability to repay. The CFPB's recent analysis of thousands of bank payday loans found a median number of advances per borrower of 14, with extremely high numbers of advances for many borrowers.[32] Fourteen percent of borrowers who took out more than $9,000 in loans over 12 months took out a median of 38 advances.[33]

The CFPB further found that borrowers were indebted an average of 112 days during the year, with borrowers with $9,000 or more in loans spending an average of 254 days in debt.[34] And it found an average of only 13 days between "advance balance episodes,"[35] indicating that bank payday loans do not typically sustain borrowers through even a single pay cycle. For those with more than $9,000 in loans, the average number of days between episodes was six.[36]

These findings are consistent with CRL's recent analysis of bank payday loans, which found that the median bank payday borrower took out 13.5 loans in 2011 and was in bank payday loan debt at least part of six months during the year—that is, a typical borrower had one or more bank payday loans outstanding at some point during six discrete calendar months during the year.[37] The mean number of loans was 19, far higher than the median, because over a third of borrowers had more than 20 loans.[38]

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obligations, employment status, and other relevant financial resources, the lender is effectively counting on its ability to seize the borrower's equity in the collateral to satisfy the obligation and to recover the typically high fees associated with such credit."

[32] CFPB Findings at 34.

[33] *Id.* at 33-34.

[34] *Id.* at 37.

[35] *Id.* at 40. The CFPB defines "advance balance episode" as the consecutive days during which a consumer has an outstanding deposit advance balance. *Id.* at 27.

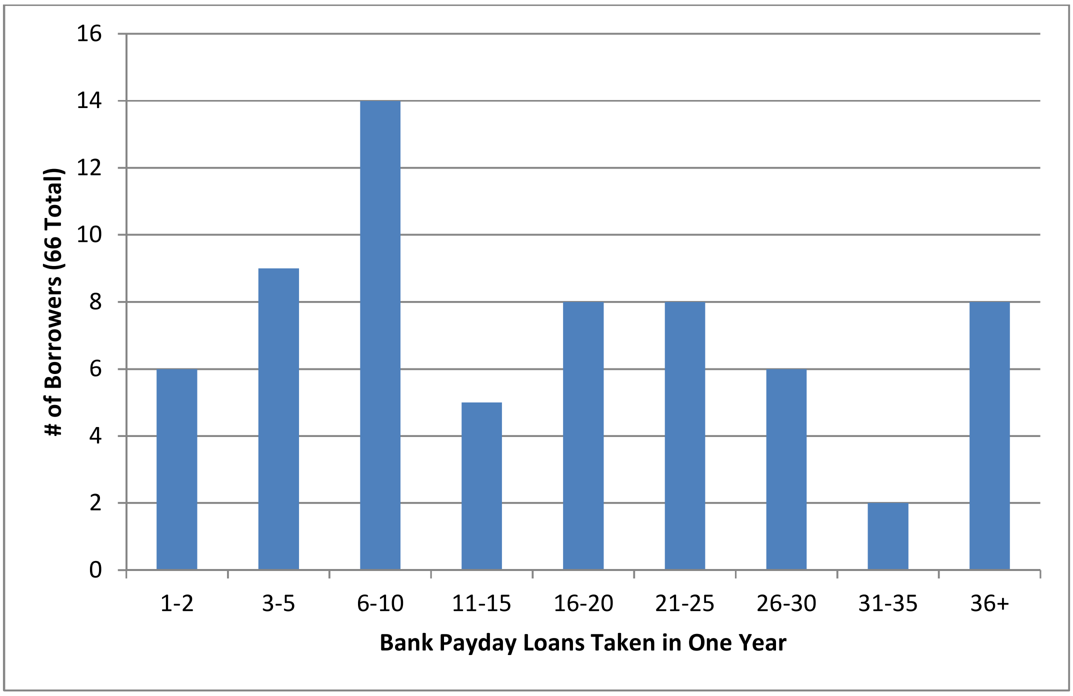
[36] *Id.* at 40.

[37] Rebecca Borné and Peter Smith, *Triple Digit Danger: Bank Payday Lending Persists* (March 21, 2013), Center for Responsible Lending, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/Triple-Digit-Bank-Payday-Loans.pdf [hereinafter CRL, *Triple Digit Danger*].

[38] *Id.*

As Figure 1 illustrates, CRL found that many borrowers take out twenty, thirty, or more loans annually:[39]

Figure 1: Bank Payday Loans Taken in One Year



Source: CRL report, *Triple Digit Danger* (March 2012) (based on analysis of Lightspeed checking account data)

These data clearly refute banks' claims that these products are meant for occasional use to manage a short-term cash shortfall and not as long-term credit.[40] We are aware of no data on bank payday lending inconsistent with the data above.

3. Ineffective safeguards do not prevent the cycle of debt.

Banks often point to "safeguards" they have in place to ensure that borrowers do not become trapped in long-term debt, including installment plans and ineffective cooling-off periods.[41] The data discussed above clearly demonstrate that these "safeguards" are not effective. As the Agencies note, banks that offer installment plans impose obstacles to qualifying for them.[42] For

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[39] *Id.*

[40] Every bank we know of making payday loans tells customers the product is intended for short-term rather than long-term use. For an example from each of these banks, *see* Appendix.

[41] In the payday lending context, a "cooling-off" period is a period following repayment of one payday loan during which the lender will not extend the consumer another payday loan.

[42] FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354.

example, Wells Fargo Bank's "payment plan" (which allows payments in $100 increments rather than balloon repayments) is available only to customers who have already been in balloon payment loans in three consecutive months and have at least $300 in bank payday debt outstanding.[43]

Banks' cooling-off periods allow borrowers to become mired in a cycle of debt before the cooling-off period is triggered. Wells Fargo Bank's cooling-off policy, for example, allows six consecutive months of loans until a one-month cooling-off period.[44] After six consecutive months with loans, a borrower will typically have paid hundreds of dollars in fees and still owe the original principal on the loan. By contrast, if provided an affordable loan at the outset, after six months the borrower would have been finished, or be well on the way toward, paying off the loan. Thus, a cooling-off period is not a substitute for a meaningful determination of the borrower's ability-to-repay at the outset.

These bank "safeguards" are the same ones that non-bank payday lenders have long touted but that have proven ineffective in that context as well.[45]

B. Lending without regard to ability to repay is a safety and soundness issue.

Regulatory precedent has long clearly established that lending without regard to ability to repay is a safety and soundness issue. Other troubling characteristics of consumer lending practices have also been addressed on safety and soundness grounds. This has been true even when a product has proven profitable to banks in the short-term.

1. Banking regulators have long cautioned that collateral-based lending—that is, lending without regard for ability to repay—is a safety and soundness issue.

The OCC, FDIC, and FRB have consistently addressed collateral-based lending—that is, lending without regard for ability to repay—on safety and soundness grounds.[46] As the Agencies'

[43] Wells Fargo Direct Deposit Advance Service Agreement and Product Guide, Effective May 14, 2012 with Addenda effective January 29, 2012; July 15, 2012; and October 22, 2012 at 4, *available at* https://www.wellsfargo.com/downloads/pdf/checking/dda/termsandconditions_english.pdf.

[44] *Id.*

[45] CRL examined millions of loans across several states that adopted similar "best practices" to ostensibly reform payday loans. Nevertheless, there was no measureable reduction in repeat borrowing. For example, over 60 percent of all loans from these states go to borrowers with 12 or more transactions in a year. *See generally*, Uriah King and Leslie Parrish, *Springing the Debt Trap: Rate caps are the only proven reform*, December 13, 2007, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf [hereinafter CRL, *Springing the Debt Trap*].

[46] For CRL's issue brief discussing how bank payday lending poses safety and soundness risk and relevant regulatory precedent, *see* Center for Responsible Lending, *Prudential Regulators Should Apply Safety and Soundness Standards to Bank Payday Loan Products*, January 24, 2013, *available at* http://rspnsb.li/Yqd0uH.

current proposal notes, the 2001 Interagency Subprime Guidance cautioned that "Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound."[47]

The OCC's 2000 payday loan guidelines, which explicitly applies to both payday lending done directly by banks and programs operated by third parties,[48] cautioned: "[M]ultiple renewals without principal reduction . . . are not consistent with safe and sound banking principles."[49]

In 2007, the agencies issued a statement on subprime mortgage lending, again emphasizing, as a risk management practice, the need to assess the borrower's ability to repay the loan rather than relying predominantly on collateral: "[I]nstitutions should ensure they do not engage in . . . [m]aking loans based predominantly on the foreclosure or liquidation value of a borrower's collateral rather than on a borrower's ability to repay the mortgage according to its terms."[50]

2. Banking regulators have long addressed concerns with consumer lending products on safety and soundness grounds.

The regulators have addressed troubling characteristics of a range of consumer lending products on safety and soundness grounds, even when those practices were generating significant profits for the bank.

In the early 2000s, both the OCC[51] and the FRB[52] took enforcement actions against subprime credit card companies citing safety and soundness concerns, even as the companies were

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[47] 2001 Interagency Subprime Guidance, cited in the current proposals at FDIC: 78 Fed. Reg. 25272, n.21; OCC: 78 Fed. Reg. 25357, n.21.

[48] *Id.* at 5 ("The OCC will closely review any payday lending activities conducted directly by national banks, as well as any payday lending or financing activities conducted through arrangements with third parties.").

[49] OCC's 2000 Advisory Letter on Payday Lending, at 3.

[50] Department of the Treasury-Office of the Comptroller of the Currency, Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Interagency Statement on Subprime Mortgage Lending, 72 Fed. Reg. 37569, 37573 (July 10, 2007).

[51] In 2000, the OCC took enforcement action against Providian, requiring that it pay customers at least $300 million in the agency's largest ever enforcement action at the time. Comptroller John Hawke stated: "'When a bank engages in unfair or deceptive marketing practices, it damages its most precious asset -- the trust and confidence of its customers . . . . That relationship of trust and confidence is central to the bank's safe and sound operation. We will not tolerate abuses that breach that trust through unfair and deceptive practices . . . . This settlement . . . ensures that, going forward, Providian will conduct its business in a way that both respects the interests of its customers and protects the safety and soundness of the bank."' OCC News Release 2000-49, *Providian to Cease Unfair Practices, Pay Consumers Minimum of $300 Million Under Settlement with OCC and San Francisco District Attorney* (June 28, 2000), *available at* http://www.occ.gov/static/news-issuances/news-releases/2000/nr-occ-2000-49.pdf.

[52] In 2003, the FRB took enforcement action against First Premier on safety and soundness grounds, while noting that the bank must comply with the Board's applicable guidance related to subprime lending. *Written Agreement by and among United National Corporation, Sioux Falls, South Dakota; First PREMIER Bank, Sioux Falls, South*

recording record profits generated by these products.[53] The high fee-generating practices like those the regulators addressed at these credit card companies share stark similarities with bank payday loans—they are profitable to the bank, but largely because they trap borrowers in debt.[54]

3. Disregarding ability to repay, and the churning it results in, also poses safety and soundness risk through reputational risk and legal risk.

a. Reputational risk

The OCC's supervision manual describes reputation risk as "the risk arising from negative public opinion," which affects the bank's relationships and "may expose the institution to litigation, financial loss, or a decline in its customer base." It "includes the responsibility to exercise an abundance of caution in dealing with customers and the community."[55]

The FRB's supervision manual defines reputational risk similarly, as "the potential that negative publicity . . . will cause a decline in the customer base, costly litigation, or revenue reductions."[56]

Bank payday lending poses severe reputational risk to the few banks engaging in it.[57] Payday loans generally are unpopular and, increasingly, illegal. They are prohibited or significantly

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Dakota; PREMIER Bankcard, Inc., Sioux Falls, South Dakota; and the Federal Reserve Bank of Minneapolis, Federal Reserve Board (Sept. 25, 2003), at 3, *available at* http://www.federalreserve.gov/Boarddocs/Press/enforcement/2003/20030925/attachment.pdf.

[53] *See, e.g.*, PR Newswire, *Providian Financial Corporation Announces Record Earnings in the Second Quarter Fueled by 50% Growth in Revenues and Customers*, July 22, 1998 (noting record earnings and projected increases going forward).

[54] The founder of Providian, for example, said in 2004: "It didn't require a lot of investigation to see that the people who paid in full every month were not profitable"; the most lucrative customers were the "revolvers," who routinely carried high balances, but were unlikely to default. Robin Stein, *The Ascendancy of the Credit Card Industry*, PBS Frontline, Nov. 23, 2004, http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/rise.html (quoting Andrew Kahr, founder of Providian). The CFPB recently noted that credit losses for bank payday loans appear lower than for storefront payday loans, the latter averaging 5 percent according to industry data. CFPB Findings at 7.

[55] OCC, Bank Supervision Process, Comptroller's Handbook, at 121 (September 2007), *available at* http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/banksupervisionprocess.pdf.

[56] Federal Reserve System's Commercial Bank Examination Manual, Examination Strategy and Risk-Focused Examinations, at 4.5 (April 2011), *available at* http://www.federalreserve.gov/boarddocs/supmanual/cbem/cbem.pdf. The OCC's supervision manual's definition is similar: "Reputation risk is the risk arising from negative public opinion. This affects the institution's ability to establish new relationships or services or continue servicing existing relationships. This risk may expose the institution to litigation, financial loss, or a decline in its customer base. Reputation risk exposure is present throughout the organization and includes the responsibility to exercise an abundance of caution in dealing with customers and the community." OCC, Bank Supervision Process, Comptroller's Handbook (September 2007) at 121, *available at* http://www.occ.gov/publications/publications-by-type/comptrollers-handbook/banksupervisionprocess.pdf.

restricted in 18 states and the District of Columbia, and the numbers have been growing. Some states have never allowed these loans to be part of their small loan marketplace, while several have prohibited or significantly restricted them in recent years.[58] Since 2007, seven states and the District of Columbia have enacted or enforced meaningful reform to address payday lending[59]—while no state without payday lending has authorized it since 2005. In three recent ballot initiatives in Montana, Arizona and Ohio, voters resoundingly rejected payday lending, despite payday industry campaigns costing tens of millions of dollars.[60] In addition to the results at the ballot box, polls in several states and nationally consistently show overwhelming support for laws that do not allow high-cost payday lending.[61]

It is not surprising, then, that payday lending by banks has been met with opposition from virtually every sphere— the military community,[62] community organizations,[63] civil rights

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[57] A 2007 article on reputational risk by a FRB staff provided only a few examples of practices posing reputational risk; payday lending was one of them: "There is also a stigma attached to institutions involved with payday lending." William J. Brown, Federal Reserve Board Enforcement Specialist, *Understanding Reputational Risk: Identify, Measure, and Mitigate the Risk*, 4th Quarter 2007, *available at* http://www.phil.frb.org/bank-resources/publications/src-insights/2007/fourth-quarter/q4si1_07.cfm.

[58] High-cost single-payment payday loans are not authorized by law in the following states/jurisdictions: Arkansas, Arizona, Colorado, Connecticut, the District of Columbia, Georgia, Maine, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Vermont, and West Virginia. Although interest rate caps vary by state, most are about 36 percent APR. In a few instances, payday lenders attempt to circumvent state protections by structuring their loans to operate under other loan laws not intended for very short-term, single payment loans.

[59] The seven states are Arkansas, Arizona, Colorado, New Hampshire, Ohio, Oregon, and Montana.

[60] In Montana in 2010, 72 percent of voters said yes to lowering rates from 400 percent to 36 percent APR on all small dollar loans. In Arizona in 2008, voters in every county in the state rejected 400 percent rates in favor of restoring the state's existing 36 percent APR on unsecured loans. In Ohio, in 2008, 70 percent of voters said yes to affirm the legislatively enacted 28 percent rate cap for payday loans.

[61] In addition to the results at the ballot box, polls in several states and nationally consistently show overwhelming support for a 36 percent annual rate limit on payday loans. Recently in Iowa, Virginia and Kentucky, where recent statewide polls have been conducted to measure support for a limit to the amount of interest payday lenders can charge, both Republican and Democratic voters have responded overwhelmingly: 69-73 percent of voters in each of these states favor a 36 percent APR cap. *See* Jason Hancock, *Coalition to rally for payday lending reform*, Iowa Independent (Jan. 26, 2011), *available at* http://iowaindependent.com/51369/coalition-to-rally-for-payday-lending-reform; Ronnie Ellis, *Payday Lenders Targeted for Interest Rates*, The Richmond Register (Feb. 8, 2011), *available at* http://richmondregister.com/localnews/x2072624839/Payday-lenders-targeted-for-interest-rates; Janelle Lilley, *Virginia Payday Lending Bill Dies in Senate, Survives in House*, WHSV.com (Jan.18, 2011), *available at* http://www.whsv.com/home/headlines/Virginia_Payday_Lending_Bill_Dies_in_Senate_Survives_in_House_114169549.html.

A 2009 national survey found that three out of four Americans who expressed an opinion thought Congress should cap interest rates; 72 percent thought the cap should be no higher than 36 percent annually. Center for Responsible Lending, *Congress should cap interest rates: Survey confirms public support for cracking down on high-cost lending* (March 2009), *available at* http://www.responsiblelending.org/payday-lending/policy-legislation/congress/interest-rate-survey.pdf.

[62] *See, e.g.*, Testimony of Steve Abbot, former President of the Navy-Marine Corps Relief Society, Before the U.S. Committee on Banking, Housing and Urban Affairs (Nov. 3, 2011) (noting bank payday loans among the "most

leaders,[64] socially responsible investors,[65] state legislators,[66] and members of Congress[67]—which has resulted in widespread negative publicity.[68]

In North Carolina, a state that does not permit payday lending, public outcry and state attorney general opposition led Regions Bank to stop making its payday loans there in January.[69] North

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egregious trends"), http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=ca463f82-0902-4a6d-9a08-d8b7e6860fe0; Comments of Michael Archer, Director of Military Legal Assistance, Marine Corps Installations East, to CFPB (April 4, 2012): "Most ominously, a few large banks have gotten into the business of payday loans through the artifice of calling the loans open ended credit" http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0009-0056.

[63] Hundreds of groups have urged the prudential regulators to stop banks from trapping borrowers in payday loans. Letters from approximately 250 groups to FDIC, OCC, FRB and CFPB, March 13, 2013 (http://ourfinancialsecurity.org/blogs/wp-content/ourfinancialsecurity.org/uploads/2013/03/Bank-Payday-Sign-On-Letter-3-13-13-Final.pdf) and February 22, 2012 (http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Dear-Regulators.pdf). Thousands of individuals and many community groups filed comments with the OCC urging that Wells Fargo's Community Reinvestment Act rating be negatively impacted because it makes payday loans. The comment filed by CRL and NCLC is available here: http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/cra-comment_wells-nov-29-2012_final.pdf.

[64] *E.g.*, Letter from Benjamin Todd Jealous, President and Chief Executive Officer, NAACP, to FDIC, OCC, FRB, and CFPB opposing bank payday lending (Feb. 21, 2013).

[65] For proxy year 2013, investors filed shareholder resolutions with the four largest banks making payday loans expressing concern about the product and requesting data, which none of the banks agreed to provide. Wells Fargo (http://www.onlineethicalinvestor.org/eidb/wc.dll?eidbproc~reso~10525); Fifth Third Bank (http://www.trilliuminvest.com/resolutions/payday-lending-fifth-third-bancorp-2013/); Regions Bank and U.S. Bank (http://www.calvert.com/sri-resolutions.html).

[66] *E.g.*, "Legislative Black Caucus slams Regions Bank over payday-style loans," Raleigh News and Observer "Under the Dome," Oct. 11, 2012, *available at* http://projects.newsobserver.com/under_the_dome/legislative_black_caucus_slams_regions_bank_over_paydaystyle_loans#storylink=cpy#storylink=cpy (quoting letter from N.C. Senator Floyd McKissick, Jr., chairman of the N.C. Legislative Black Caucus, to Regions Bank, which stated: "We are deeply concerned about recent reports of Regions Bank offering its 'Ready Advance' payday loans in North Carolina . . . . High-cost, short-term balloon loans like these sharply increase the financial distress of families under economic strain"); Letter from Arizona Democratic Caucus to the prudential banking regulators, February 2012 (noting that Arizona "has spent countless state resources to study and understand the effects of [payday lending], and ultimately outlaw payday lending entirely" and calling on federal regulators to "take immediate action so that meaningful reforms taking place in Arizona and throughout the country in the name of consumer protection will not be undermined.").

[67] In January 2013, several Senators wrote the FRB, OCC, and FDIC urging action to address bank payday lending (http://www.blumenthal.senate.gov/newsroom/press/release/blumenthal-calls-on-regulators-to-act-to-stop-abusive-bank-payday-lending). In April 2013, House members did the same (http://democrats.oversight.house.gov/images/stories/Bank%20payday_Letter%20to%20Prudential%20Regulators.pdf).

[68] For documentation of recent opposition to bank payday lending by community leaders and state and local officials, *see* Center for Responsible Lending, *Bank Payday Lending: Overview of Media Coverage and Public Concerns*, CRL Issue Brief, March 7, 2013, *available at* http://rspnsb.li/10wra0y.

Carolina Attorney General Roy Cooper said the following when discussing Regions Bank's product: "Payday loans are like a consumer needing a life preserver being thrown an anvil."[70]

Bank payday lending has motivated "move-your-money" campaigns.[71] It has led groups managing programs aiming to bring people into the banking mainstream to establish policy that excludes banks that make high-cost payday loans from the program.[72] Multiple lawsuits involving bank payday loans have been filed.[73] And in light of growing regulatory scrutiny of bank payday lending, and payday lending generally, there is clear risk that regulatory action against the product, on a safety-and-soundness or a consumer protection basis, will cause banks to lose substantial revenue associated with it. Indeed, the CFPB recently noted that it "expects" to use its authorities to provide protections against harm caused by sustained use of payday loans, whether offered by non-bank payday lenders or by banks.[74]

b. Legal risk

The Agencies discuss a variety of legal risks payday lending poses in their proposal. We underscore here the risks of violating (1) federal and state provisions prohibiting unfair and deceptive acts or practices and (2) the Equal Credit Opportunity Act (ECOA). Unfair and deceptive acts or practices typically stem from causing consumer harm which, as we discuss in Part III below, bank payday lending clearly causes. ECOA prohibits creditors from discriminating on the basis of, among other characteristics, race, color, or age.[75] Discrimination

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[69] D. Ranii, *Regions Bank stops offering controversial loans in N.C.*, Raleigh News and Observer (Jan. 17, 2013), *available at* http://www.newsobserver.com/2013/01/17/2614414/regions-bank-stops-offering-controversial.html#storylink=cpy.

[70] D. Ranii, *Regions Bank assailed for payday-style loan*, Raleigh News and Observer (Sept. 18, 2012, *available at* http://www.newsobserver.com/2012/09/18/2352194/regions-bank-assailed-for-payday.html.

[71] *See, e.g.*, Green America's "Break up with your mega bank" campaign focused on bank payday lending: http://breakupwithyourmegabank.org/. In addition, a 2012 North Carolina poll found that 93 percent of respondents were less likely to use a bank that makes payday loans that violate North Carolina law. North Carolina Justice Center, *Regions Bank Halts Illegal Payday Lending in North Carolina* (Jan. 16, 2013), *available at* http://www.ncjustice.org/?q=consumer-and-housing/media-release-regions-bank-halts-illegal-payday-lending-north-carolina (citing Public Policy Polling poll conducted on behalf of CRL, Sept. 2012).

[72] In 2012, "Bank On" Savannah (Ga.) adopted as policy that participating banks may not make deposit advance products in excess of 36% APR. Agreement on file with CRL. Relatedly, Cities for Financial Empowerment, the organization that supports cities in implementing "Bank On" programs to bring people into the banking mainstream, has written to the prudential regulators expressing serious concerns about bank deposit advance programs (http://cfefund.org/sites/default/files/Deferred%20Deposit%20Advances.pdf).

[73] Three class action lawsuits have been filed against Fifth Third Bank within the last year: *Klopfenstein v. Fifth Third Bank*, S.D. Ohio (Aug. 3, 2012); *Laskaris v. Fifth Third Bank*, S.D.Ca. (Feb. 12, 2013); *Jesse McQuillen v. Fifth Third Bank*, W.D. Ky. (May 7, 2013).

[74] CFPB Findings at 44.

[75] 15 U.S.C. 1591 *et seq*.

can be proven through overt evidence of discrimination, evidence of disparate treatment, or evidence of disparate impact.[76] Given the impact payday lending has on communities of color and older Americans discussed in Part III.E below, banks making payday loans are at significant risk of being found in violation of this law.

As collection and analysis of bank payday loan data continues to become more robust, the likelihood that violations of the law will be identified and acted upon only increase.

III. The cycle of debt, and resulting extraordinarily high accumulated fees, causes severe consumer harm, contributing to safety and soundness risk.

Bank payday lending poses the safety and soundness risk discussed above in part because it causes severe harm to banks' customers. Research on the payday lending industry demonstrates that the cycle of debt—which the data increasingly show is typical, including for bank payday loans—causes severe harm. Payday lenders themselves, including banks making payday loans, have long acknowledged that repeat loans are harmful. Further, regulatory precedent has long provided that repeat payday loans cause harm, that loan churning generally causes harm, and that other analogous practices cause harm. Certain subsets of the population are particularly at risk to the harms caused by bank payday lending: older Americans, communities of color, and military servicemembers.

A. Research makes clear that repeat payday loans cause severe harm.

There is a growing body of evidence that the cycle of debt resulting from making payday loans without regard to the borrower's ability to repay causes severe harm—that is, it leaves borrowers worse off than if they had never taken out a payday loan in the first place.

Research has long shown that payday loans cause serious financial harm to borrowers, including increased likelihood of bankruptcy, paying credit card debts and other bills late, delayed medical care, and loss of basic banking privileges because of repeated overdrafts.[77]

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[76] Interagency Task Force on Fair Lending, Policy Statement on Discrimination in Lending, 59 Fed. Reg. 18266 (Apr. 15, 1994), *available at* www.occ.treas.gov/news-issuances/federal-register/94fr9214.pdf (noting that the courts have recognized those three methods of proving lending discrimination under the ECOA). Regulation B under ECOA also recognizes that the legislative history of ECOA indicates Congress intended an "effects test" concept. 12 C.F.R. § 1002.6. The CFPB recently reaffirmed the disparate impact test and confirmed it would be applying it in its supervisory examinations. CFPB Bulletin 2012-04 (Fair Lending) (April 18, 2012), *available at* http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf.

[77] *See* the following studies for discussions of these negative consequences of payday lending: Paige Marta Skiba and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?* Vanderbilt University and the University of Pennsylvania (October 10, 2008), *available at* www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/publication/download.aspx?id=2221; Sumit Agarwal, Paige Skiba, and Jeremy Tobacman. *Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?* Federal Reserve of Chicago, Vanderbilt University, and the University of Pennsylvania (January 13, 2009), *available at* http://bpp.wharton.upenn.edu/tobacman/papers/pdlcc.pdf; Dennis Campbell, Asis Martinez Jerez, and Peter Tufano, *Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures*, Harvard Business School (June 6, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1335873; Brian T.

This is unsurprising in light of the financial strain the cycle of debt has been shown to have on borrowers over time. CRL research published in 2011, which tracked borrowers over a two-year period, found that the typical non-bank payday borrower take out loans for more and more over time as they are driven deeper into debt and that nearly half of borrowers (44 percent)—after years of cyclic debt—ultimately default.[78] Previous CRL research has found that the typical borrower will pay back $793 in principal, fees, and interest for the original $325 borrowed.[79]

Other studies support CRL's findings. For example, in his book on the history of the payday lending industry, Professor Robert Mayer finds that one in four payday borrowers ultimately default, concluding that these borrowers "flounder and drown, but in most cases not before they have generated more in fee income than must be written off in principal."[80]

Another study of a large Texas-based payday lender found a 54 percent default rate for payday borrowers who took out loans on a bi-weekly basis; the study concluded that by the time the borrower defaults, he or she will have serviced that payday loan five or six times and have paid over 90 percent of the amount of the principal in fees and interest alone.[81]

A real-life case study from our database of bank payday borrowers provides an example of the harm caused to one borrower over the course of a six-month period:

Melzer, *The Real Costs of Credit Access: Evidence from the Payday Lending Market*, University of Chicago Business School (November 15, 2007), *available at* http://insight.kellogg.northwestern.edu/index.php/Kellogg/article/the_real_costs_of_credit_access; and Bart J. Wilson, David W. Findlay, James W. Meehan, Jr., Charissa P. Wellford, and Karl Schurter, "An Experimental Analysis of the Demand for Payday Loans" (April 1, 2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1083796.

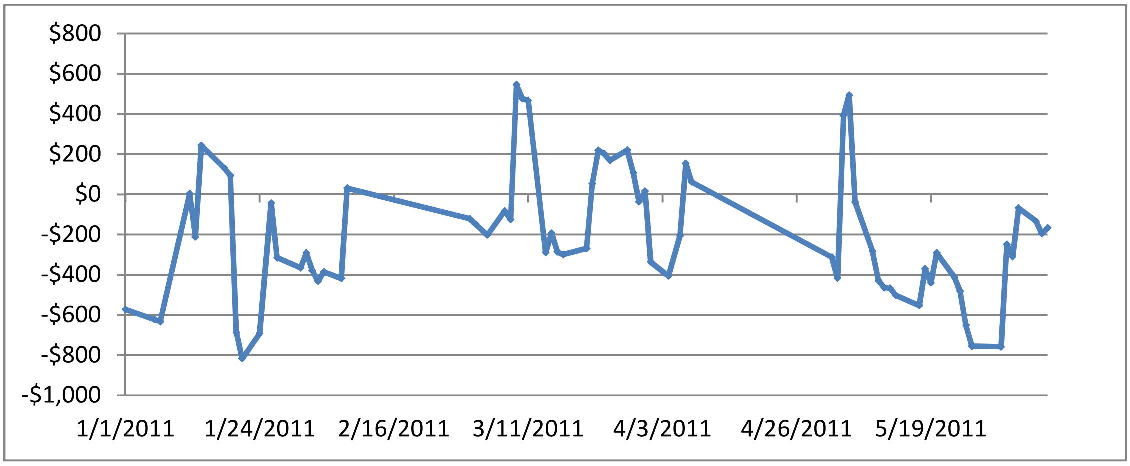
[78] CRL's analysis of Oklahoma payday lending data showed that payday borrowers were loaned greater amounts over time (i.e., an initial loan of $300 loan increased to $466) and more frequently over time (borrowers averaged nine loans in the first year and 12 in the second year), and that eventually, nearly half of borrowers (44 percent) defaulted. Uriah King & Leslie Parrish, *Payday Loans, Inc.: Short on Credit, Long on Debt* at 5 (Mar. 31, 2011), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-loan-inc.pdf [hereinafter CRL, *Payday Loans, Inc.*]. The report was based upon 11,000 Oklahoma payday borrowers who were tracked for 24 months after their first payday loan.

[79] Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year* at 6, Center for Responsible Lending (Nov. 30, 2006), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/rr012-Financial_Quicksand-1106.pdf.

[80] Robert Mayer, *Quick Cash: The Story of the Loan Shark* at 152-53, Northern Illinois University Press (2010).

[81] Paige Marta Skiba and Jeremy Tobacman, *Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default*, Vanderbilt University Law School and University of Pennsylvania (Aug. 21, 2008), *available at* http://www.law.vanderbilt.edu/faculty/faculty-personalsites/paige-skiba/publication/download.aspx?id=1636.

Figure 2: Melinda's Checking Account Balance – January to June 2011



Melinda is a 33-year-old residing in Texas. During the five-and-half-months during which she provided her account information to Lightspeed, Melinda had 19 bank payday loans, typically grouped into clusters of 2-3 loans extended over the course of a few days each month. The median loan size was only $100, yet Melinda paid $233.50 in fees. She also incurred 21 overdraft fees during this period. At the end of the period, her account remained in the red.

B. Payday lenders themselves have long acknowledged that repeat payday loans cause harm.

Payday lenders themselves have long acknowledged that long-term use of what is intended to be a short-term product is harmful. Every bank of which we are aware making payday loans cautions that these loans are not intended for repeat or long-term use.[82] And the Community Financial Services Association of America (CFSA), the payday industry's trade group, stated in its consumer guide that payday loans are "not a long-term solution" and that "[r]epeated or frequent use of payday advances can cause serious financial hardship."[83]

Yet even as they purport to discourage long-term use, payday lending industry representatives have often acknowledged that repeat borrowing not only occurs but is encouraged.[84] Payday

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[82] *See* Appendix.

[83] *Your Guide to Responsible Payday Advances,* Community Financial Services Association of America, *viewed at* www.cfsa.net/downloands/Your_Guide_to__Responsible_Use _of_Payday_Advances_English.pdf (viewed on 3/31/11).

[84] Several examples are cited in CRL, *Springing the Debt Trap*, at 11-12, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/springing-the-debt-trap.pdf: "A note about rollovers. We are convinced the business just doesn't work without them" (Roth Capital Partners, First Cash Financial Services, Inc., Company Update, July 16, 2007); "We saw most of our customers every month—a majority came in every month" (Rebecca Flippo, former payday lending store manager, Henrico County, VA); "This industry could not survive if the goal was for the customer to be 'one and done.' Their survival is based on the

lenders also frequently offer the borrower's first loan for free or at a discount, further exposing that repeat loans are expected.[85]

C. Research demonstrates that bank payday borrowers are more likely to incur overdraft fees.

Banks have pitched their payday loans as a way for customers to avoid overdrafts and associated overdraft fees.[86] The Agencies note, however, that weak underwriting associated with bank payday lending increases the risks that the borrower's account will become overdrawn and overdraft fees will be incurred.[87] Indeed, the CFPB's analysis found that 65 percent of bank payday borrowers incurred overdraft fees, which was more than three-and-a-half times the portion of customers eligible for a bank payday loan who did not take one out.[88]

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ability to create the need to return, and the only way to do that is to take the choice of leaving away. That is what I did" (Stephen Winslow, former payday lending store manager, Harrisonburg, VA).

Wells Fargo has also on occasion acknowledged that "[m]any [borrowers] fall into a recurring cycle of taking advances to pay off the previous advance taken." Wells Fargo insider quoted in David Lazarus, *120% rate for Wells' Advances*, San Francisco Chronicle, Oct. 6, 2004.

Payday industry researchers and analysts have noted the same: "The financial success of payday lenders depends on their ability to convert occasional users into chronic borrowers" (Michael Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing," *Economic Development Quarterly*, Vol. 17, No. 1 (February 2003); "We find that high-frequency borrowers account for a disproportionate share of a payday loan store's loan and profits… the business relies heavily on maximizing the number of loans made from each store" (Flannery and Katherine Samolyk, *Payday Lending: Do the Costs Justify the Price?* FDIC Center for Financial Research (June 2005), *available at* http://www.fdic.gov/bank/analytical/cfr/2005/wp2005/CFRWP_2005-09_Flannery_Samolyk.pdf).

[85] A survey of company websites and direct mail advertisements of the 15 largest payday lending companies from 2008-2010 showed that nine of these companies offered a free or discounted first loan and six offered a discount on loans for returning customers. CRL, *Payday Loans, Inc.* at 12. Offering a free first loan gives demonstrates industry's confidence that borrowers will need to return often for new loans once the payday lending cycle begins, making up for an initial "discount" many times over.

[86] CFPB Findings at 40; Burbach, K., Hargarten, J., Heskett, C., & Schmickle, S., *Big Banks' quick-cash deals: Another form of predatory lending?* MinnPost (Feb. 4, 2013); Wells Fargo Bank's comment to CFPB (Apr. 23, 2012) (noting: "[The deposit advance loan] allows a customer to quickly move money into their checking account when needed to help cover an unexpected expense or bill . . . . they can avoid higher cost overdraft fees . . . ."); Wells Fargo Bank's 2012 product agreement (providing a chart comparing borrowing $300 for 30 days as costing $22.50 with the deposit advance (payday loan) product versus $70 with overdraft (assuming two overdraft items at $35 each) and also stating: "If you find yourself in a situation where the funds in your . . . checking account may be insufficient to cover checks or other items that will post to your deposit account, you may choose to advance from [the direct deposit advance] service to avoid the overdraft . . . . The Direct Deposit Advance service is an expensive form of credit, and while the advance fee may be lower than an overdraft or insufficient funds fee, you may want to consider speaking with a banker regarding overdraft protection options that may be available to you.").

[87] FDIC: 78 Fed. Reg. 25270; OCC: 78 Fed. Reg. 25355.

[88] CFPB Findings at 41. CRL's previous research had found similar results—that nearly two-thirds of bank payday borrowers also incurred overdraft fees, and these borrowers were two times more likely to incur overdraft fees than bank customers as a whole. CRL, *Triple Digit Danger.*

The CFPB further found that a quarter of the bank payday borrowers most heavily steeped in the cycle of debt incurred an average of 18 or more overdraft or non-sufficient funds fees during the 12-month period.[89]

These findings are consistent with what consultants selling bank payday loan software have promised banks: that payday lending will result in little-to-no "overdraft revenue cannibalization."[90] The findings also confirm prior research finding that non-bank payday loans often exacerbate overdraft fees, leading to checking account closures.[91]

D. Federal regulators have long cautioned that repeat payday loans, lending without regard to ability to repay more generally, and high fees due within a short period, cause consumer injury.

Regulators have long cautioned that long-term use of payday loans causes injury. The FDIC's 2007 affordable small loan guidelines caution that "the inability to repay these short-term, high-cost credit products often leads to costly renewals and *exacerbates a customer's difficulties in meeting cash flow needs*."[92] In its warning to national banks considering partnering with payday lenders, the OCC stated that repeatedly renewing a payday loan either through extending a loan directly or through a series of back-to-back transactions was an exceedingly expensive and unsuitable way to borrow over the long term.[93] The National Credit Union Administration (NCUA) has also concluded that extensive use of payday loans is harmful.[94]

The CFPB has also recently discussed the harm that debt traps cause, noting that they "can turn short-term credit into long-term debt that deepens people's problems and leaves them worse off . . . . For a certain subset of borrowers, the fees will pile up and people will ultimately end up worse off than before taking the first loan."[95]

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[89] CFPB Findings at 42.

[90] Fiserv, Relationship Advance program description, retrieved from http://www.relationshipadvance.com/ in August 2011, on file with the Center for Responsible Lending.

[91] Center for Responsible Lending, *Payday Loans Put Families in the Red* (2009), *available at* http://www.responsiblelending.org/payday-lending/research-analysis/payday-puts-families-in-the-red-final.pdf.

[92] FDIC Financial Institution Letters, *Affordable Small Dollar Loan Products, Final Guidelines*, FIL-50-2007 (June 19, 2007), *available at* http://www.fdic.gov/news/news/financial/2007/fil07050a.html [hereinafter FDIC Affordable Small Loan Guidelines].

[93] OCC Advisory Letter on Payday Lending.

[94] National Credit Union Administration, *Short-Term, Small Amount Loans*, Final Rule, Sept. 2010, *available at* http://www.ncua.gov/GenInfo/BoardandAction/DraftBoardActions/2010/Sep/Item3b09-16-10.pdf.

[95] Prepared Remarks of Richard Cordray, Director of the CFPB, to National Association of Attorneys General. February 26, 2013, *available at* http://www.consumerfinance.gov/speeches/prepared-remarks-of-richard-cordray-at-a-meeting-of-the-national-association-of-attorneys-general/.

More generally, federal regulators have found that lending without regard to ability to repay and equity stripping cause harm. In 2009, the FRB found that lending without regard to a borrower's ability to repay a higher priced or HOEPA mortgage loan caused substantial injury.[96] It found that [l]ending without regard to repayment ability . . . facilitates an abusive strategy of 'flipping' borrowers in a succession of refinancings . . . that actually . . . convert borrowers' equity into fees for originators without providing borrowers a benefit."[97] It also noted that lending without regard to ability to repay could cause "serious emotional hardship."[98] Similarly, the OCC's 2003 letter addressing predatory and abusive lending cautioned that "[e]quity stripping practices will almost always involve substantial consumer injury."[99]

Banking regulators have found in other contexts that fees required to be repaid over a short period of time increase potential injury. For example, the FRB, Office of Thrift Supervision (OTS), and NCUA noted that the potential for injury caused by high-cost subprime credit cards increases when deposits and fees are charged to the account in the first billing cycle rather than over a longer period of time: "[C]onsumers who open a high-fee subprime credit card account are unlikely to be able to pay down the upfront charges quickly."[100] Also in the high-cost credit card context, those agencies determined that costs above a reasonable threshold cause substantial consumer injury.[101] Payday loans are similar in that they require very high fees to be repaid in very short order.

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[96] It found substantial injury even if allowing refinancing into a loan with a lower payment was an option, noting that refinancing can slow the rate at which the consumer is able to pay down the principal and build equity. 73 Fed. Reg. 44541.

[97] 73 Fed. Reg. 44542.

[98] *Id.* The CFPB's Supervision and Examination Manual notes that "[e]motional impact and other more subjective types of harm also will not ordinarily amount to substantial injury. Nevertheless, in certain circumstances . . . emotional impacts may amount to or contribute to substantial injury." CFPB Supervision and Examination Manual, Version 2 (Oct. 2012), CFPB Consumer Laws and Regulations—UDAAP, at 2.

[99] OCC 2003 Advisory Letter on Predatory and Abusive Lending at 6.

[100] Board of Governors of the Federal Reserve System, Office of Thrift Supervision, Treasury, and National Credit Union Administration, Unfair and Deceptive Acts and Practices, Final Rule, 74 Fed. Reg. 5498, 5539 (Jan. 29, 2009).

[101] The FRB, OTS and NCUA concluded that upfront security deposit and fees exceeding 50% of the initial credit limit caused substantial consumer injury. They further determined that such costs exceeding 25% of the initial credit limit must be charged to the account over six months. 74 Fed. Reg. 5538.

E. Payday lending by banks has a uniquely harmful impact on certain segments of the population.

1. A large portion of bank payday borrowers are older Americans receiving Social Security benefits.

Senior Americans are at particular risk of harm from bank payday loans. CRL's recent analysis of bank payday loans found that more than one-quarter of bank payday borrowers are Social Security recipients.[102] This finding was consistent with CRL's previous analysis of 2010 loans, which found that nearly one-quarter of all bank payday borrowers were Social Security recipients.[103]

Many senior Americans are financially vulnerable. The Great Recession led to a 13 percent decrease in net worth for households headed by someone age 65 or older from 2005 to 2010.[104] Coupled with declines in the value of their largest assets—homes and retirement assets—many older Americans struggle with limited incomes. More than 13 million older adults are considered economically insecure, living on $21,800 a year or less.[105] People over age 55 make up the fastest-growing segment of people seeking bankruptcy protection.[106]

The threat bank payday loans pose to Social Security recipients became more pronounced March 1 of this year, when electronic distribution of government benefits became mandatory.[107] Benefits that have been distributed by paper check, often to those most financially vulnerable, are now directly deposited to checking accounts or prepaid cards. As part of the new rule, the Treasury Department prohibited government deposits to prepaid cards that allow payday loans out of concern that credit products would siphon off exempt benefits.[108] However, benefits

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[102] CRL, *Triple Digit Danger*.

[103] Rebecca Borné, Joshua Frank, Peter Smith, and Ellen Schloemer, *Big Bank Payday Loans: High interest loans through checking accounts keep customers in long-term debt* (July 2011), Center for Responsible Lending, *available at* http://www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf.

[104] U.S. Census Bureau, *Net Worth and Asset Ownership of Households* (2005 and 2010), *available at* https://www.census.gov/hhes/www/wealth/wealth.html

[105] National Council on Aging, *A Blueprint for Increasing the Economic Security of Older Adults: Recommendations for the Older Americans Act* (March 2011), *available at* http://www.ncoa.org/assets/files/pdf/Blueprint-White-Paper-web.pdf.

[106] Brandon, E. *More Seniors Declaring Bankruptcy in Retirement*. US News and World Report (Nov. 17, 2010), *available at* http://money.usnews.com/money/blogs/planning-to-retire/2010/11/17/more-seniors-declaring-bankruptcy-in-retirement.

[107] Department of the Treasury, Interim Final Rule, Federal Government Participation in the Automated Clearing House, 75 Fed. Reg. 80335, 80338 (2010).

[108] The Treasury Department rule states: "In order to prevent Federal payments from being delivered to prepaid cards that have payday lending or 'account advance' features, we are prohibiting prepaid cards from having an attached line of credit if the credit agreement allows for automatic repayment of a loan from a card account triggered

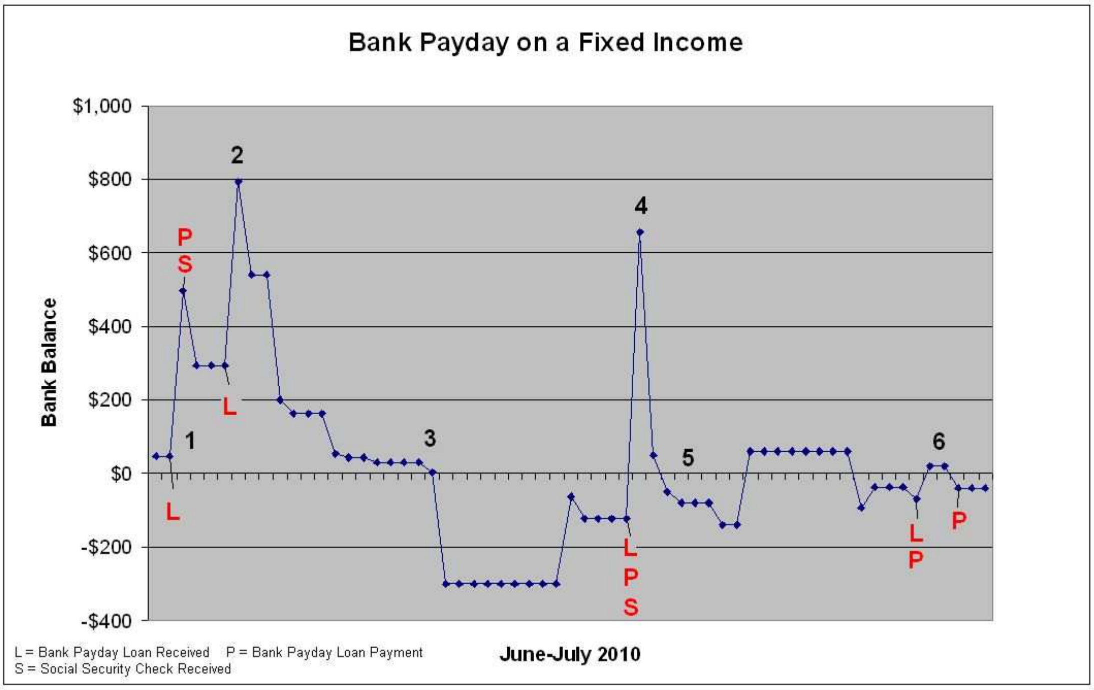
deposited into traditional checking accounts remain at risk to bank payday loans, where banks repay themselves the loan amount before any other expense or creditor.[109]

Figure 3 below demonstrates the impact that bank payday loans have on a Social Security recipient in CRL's 2010 database, whom we call Alice. Alice's primary source of income is Social Security. The figure maps two months of her checking account activity and demonstrates how bank payday loans only make it more difficult for Alice to use her Social Security income for the bills and other expenses for which it is intended. The line on the graph represents Alice's account balance. It goes up when she receives a direct deposit or other deposit or when a payday loan or overdraft loan are extended on her account. It goes down when checks, bill payments, debit card transactions, or other withdrawals are posted to the account, or when the bank collects the payday loans (after a direct deposit is received) or overdrafts and related fees.

by the delivery of the Federal payment into the account. Our intention is that this restriction will prevent arrangements in which a bank or creditor 'advances' funds to a cardholder's account, and then repays itself for the advance and any related fees by taking some or all of the cardholder's next deposit." 75 Fed. Reg. 80338.

[109] In its discussion, Treasury cited Regulation E's prohibition on compulsory electronic repayments as the comparable protection on traditional checking accounts, *id.*, but this prohibition is typically not read to apply to single-payment loans, as bank payday loans typically are. Thus, federal benefits direct deposited to traditional checking accounts remain vulnerable to bank payday loans.

Figure 3



1: Bank payday loan takes balance up to $500.
2: Alice receives June Social Security Check, and bank uses deposit to pay off first bank payday loan. Alice then takes out second bank payday loan, reaching her highest balance for the two-month period.
3: Several large bills and payments put Alice on the verge of overdraft, and the payback for the payday loan is about to come due.
4: July's Social Security Check and a new bank payday loan bring Alice's account balance to positive for only a few days.
5: More bills and the payday loan repayment take her right back into overdraft.
6: Small bills and payday loan fees and repayments offset small deposits, transfers, and bank payday loans, and Alice begins August in the red.

This graph demonstrates that bank payday loans only briefly increase Alice's account balance. Several days later, when the principal and fees ($10 per $100 borrowed in this case) are collected in one lump sum, Alice's account balance drops dramatically and overdraft fees soon follow. At the end of a two-month period during which Alice spent 47 of 61 days in payday loan debt, she is again left with a negative balance, in an immediate crisis, in need of another loan.

In CRL's recent report on bank payday loans, we also highlighted the story of another senior borrower, whom we called Annette. Annette is a 69-year-old, disabled widow who lives on a fixed income in California. More than two years ago, she found herself unable to afford the fees for smog repair and registration for her truck. Her bank, Wells Fargo, suggested that she take out a Direct Deposit Advance. In the 26 months since, from January 2011 through February 2013, Wells Fargo has made 25 advances to Annette, and she has paid over $900 in fees. This is in spite of a "continuous use" policy the bank claims prevents extended indebtedness. As of the publication of our report in March, Annette remained stuck in a cycle of debt.[110]

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[110] Source: Andrea Luquetta, California Reinvestment Coalition, as included in CRL, *Triple Digit Danger*.

2. Banks harm communities of color by making payday loans.

Banks making payday loans have promoted their products as providing access to credit in communities that have few other options. But it is a false choice to say that the communities represented by several of the undersigned groups must decide between dangerous, wealth-stripping credit and none at all. Allowing the spread of high-cost credit discourages development of responsible products and entrenches a two-tier financial system: one group of consumers who can access a mainstream financial system and another group of consumers who are further marginalized and relegated to predatory lenders selling risky products.

Americans have lost income and wealth over the past decade, and the declines have been greatest for people of color. Today, white non-Hispanic families earn an average of $55,000 annually, while African Americans and Latinos earn $32,000 and $39,000, respectively.[111] The foreclosure crisis, with its devastating impact on communities of color, is exacerbating already dramatic wealth disparities.[112]

Surveys repeatedly find that borrowers of color are disproportionately detached from the traditional banking system. A recent FDIC study found that 21 percent of African American and 20 percent of Latino households are unbanked, compared to 4 percent of white households.[113] These 2011 disparities had not improved since the FDIC's 2009 survey.

Payday lending has a history of disparate impact on communities of color. A disproportionate share of payday borrowers come from communities of color,[114] and research has found that

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[111] U.S. Census Bureau, *Quick Facts*, 2011.

[112] Rakesh Kochhar, Richard Fry and Paul Taylor, *Wealth Gaps Rise to Record Highs Between Whites, Blacks, Hispanics*, Pew Research Center, Social and Demographic Trends (July 26, 2011), *available at* http://www.pewsocialtrends.org/files/2011/07/SDT-Wealth-Report_7-26-11_FINAL.pdf.

[113] 2011 FDIC National Survey of Unbanked and Underbanked Households at 14 (Sept. 2012), *available at* http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf.

[114] Amanda Logan and Christian E. Weller, *EZ Payday Loans: Who Borrows From Payday Lenders? An Analysis of Newly Available Data*, Center for American Progress (March 2009), summary of findings at page 1 (finding, based on the FRB's Survey of Consumer Finances conducted in 2007 and released in 2009 payday borrowers are more likely to be minorities); The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* at 9 (July 2012) (finding that, after controlling for other characteristics, payday loan usage was 105% higher for African Americans than for other races/ethnicities); California Department of Corporations, *Payday Loan Study* (updated June 2008), *available at* http://www.corp.ca.gov/Laws/Payday_Lenders/Archives/pdfs/PDLStudy07.pdf (finding that, although they represent about one-third of the overall state population, over half of California payday borrowers are African American and Latino); Skiba and Tobacman, *Do Payday Loans Cause Bankruptcy?*, *supra* (analysis of a database of a large Texas-based payday lender finding that African Americans (who make up approximately 11 percent of the total adult population) made up 43 percent of payday borrowers and Latinos (who make up approximately 29 percent of the total adult population) made up 34 percent of payday borrowers).

payday lenders target these communities.[115] This disparity is even more significant since African Americans and Latinos are much less likely to have a checking account than whites—a basic requirement of getting a payday loan—which would lead one to believe that the concentration of payday lenders should be lower than in white neighborhoods.

By making payday loans, banks increase the ranks of the unbanked and underbanked among communities of color, both by the direct harm the loans cause members of these communities[116] and by the negative impact these products have on the communities' trust in banks.[117]

By making payday loans, banks also undermine the Community Reinvestment Act, the objective of which is to ensure that financial institutions meet the banking needs of the communities they are chartered to serve, including low- and moderate-income neighborhoods and individuals.[118] This legal obligation is considered a *quid pro quo* for the valuable public benefits financial institutions receive, including federal deposit insurance and access to favorably priced borrowing through the Federal Reserve's discount window.[119] Making payday loans contradicts this

[115] Wei Li, Leslie Parrish, Keith Ernst, and Delvin Davis, *Predatory Profiling: The Role of Race and Ethnicity in the Location of Payday Lenders in California,* Center for Responsible Lending (March 26, 2009), *available at*: http://www.responsiblelending.org/payday-lending/research-analysis/predatory-profiling.pdf (finding that payday lenders in California are nearly eight times as concentrated in neighborhoods with the largest shares of African Americans and Latinos compared with white neighborhoods, draining nearly $247 million in fees from communities of color, and that even after controlling for income and a variety of other factors, payday lenders were 2.4 times more concentrated in African American and Latino communities); Delvin Davis, Keith Ernst, Uriah King, and Wei Li. *Race Matters: The Concentration of Payday Lenders in African-American Communities in North Carolina.* Center for Responsible Lending (March 2005) *available at* http://www.responsiblelending.org/north-carolina/nc-payday/research-analysis/racematters/rr006-Race_Matters_Payday_in_NC-0305.pdf (finding that, even when controlling for a variety of other factors, African-American neighborhoods had three times as many payday lending stores per capita as white neighborhoods in North Carolina in 2005); Assaf Oron. *Easy Prey: Evidence for Race and Military Related Targeting in the Distribution of Payday Loan Branches in Washington State,* Department of Statistics, University of Washington (March 2006) (concluding based on a study of Washington State payday lenders that "payday businesses do intentionally target localities with a high percentage of African Americans.").

[116] The FDIC found that for 9.5 percent of previously banked households who were now unbanked, the bank closed their account, and nearly half of those were closed due to overdrafts. 2011 FDIC National Survey of Unbanked and Underbanked Households at 14, 27. As discussed earlier, bank payday borrowers are more likely to incur overdraft fees than customers as a whole.

[117] Another 8.2 percent of previously banked households listed not liking dealing with banks or not trusting banks as the reason they were now unbanked. *Id.* at 27. A recent Pew study found that some bank payday borrowers mistakenly believed that bank payday loans were safer or more regulated than other payday loans because they were offered by a bank. The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans, available at* http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Small_Dollar_Loans/Pew_Choosing_Borrowing_Payday_Feb2013.pdf, at 28 (February 2013). The contrast between this expectation and the typical experience—a long-term, high-cost debt trap—likely further damages trust of banks.

[118] 12 U.S.C. 2901 *et seq*.

[119] FRB Chairman Ben S. Bernanke, "The Community Reinvestment Act: Its Evolution and New Challenges," Speech at the Community Affairs Research Conference, Washington, D.C. (March 30, 2007), *available at* http://www.federalreserve.gov/newsevents/speech/Bernanke20070330a.htm#f2.

obligation: CRA requires that banks serve communities' credit needs,[120] but the data show that these loans do the opposite, leading to repeat loans that not only leave borrowers' needs unmet but leave them affirmatively worse off than before the lending began.

3. Bank payday lending puts military service members and their families at risk.

Members of the military are also vulnerable to bank payday lending, even as they are protected by the Military Lending Act (MLA) from other payday loans. The 2006 MLA stemmed from Department of Defense and base commander concern that troops were incurring high levels of high-cost payday loan debt, which was threatening security clearances and military readiness.[121] At that time, the President of the Navy-Marine Corps Relief Society testified:

> "This problem with . . . payday lending is the most serious single financial problem that we have encountered in [one] hundred years."[122]

Congress then prohibited making payday loans to service members and their families, but banks structure their loans in a way that attempts to evade this law,[123] even making payday loans on military bases.[124]

We were encouraged by the OCC's testimony before Congress last year highlighting the importance of MLA in protecting members of the military and their dependents by "restricting the cost and terms of . . . abusive credit products." [125]

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[120] 12 U.S.C. 2901.

[121] U.S. Department of Defense, *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* (2006), *available at* www.defense.gov/pubs/pdfs/Report_to_Congress_final.pdf.

[122] Testimony of Admiral Charles Abbot, US (Ret.), President of Navy-Marine Corps Relief Society, Hearing before the Senate Banking, Housing and Urban Affairs Committee, 109th Cong. (2006).

[123] The regulation under the law covers only "closed-end" loans. 32 CFR 232.3(b). Banks categorize their payday loans as "open-end" instead, even though the due date for the loan, much like a closed-end loan, is fixed as the next deposit date or, at the latest, after 35 days.

[124] Jean Ann Fox, *The Military Lending Act Five Years Later*, Consumer Federation of America, May 29, 2012, at 58-60, *available at* http://www.consumerfed.org/pdfs/Studies.MilitaryLendingAct.5.29.12.pdf.

[125] Testimony of Grovetta Gardineer, Deputy Comptroller for Compliance Policy, Office of the Comptroller of the Currency, Before the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, U.S. House of Representatives, July 24, 2012, at 5.

IV. We support the Agencies' proposed underwriting and related guidelines taken in combination.

A. The proposed underwriting and related guidelines, in combination, help ensure borrowers can repay the loan and meet expenses without reborrowing.

In light of the risks posed by lending without regard to ability to repay and the harm caused by repeat payday loans, we support the Agencies' proposed underwriting and related guidelines which, in combination, help ensure that borrowers can afford the loan and meet ongoing expenses without reborrowing. As the weakening or the omission of any single criterion could render the guidelines as a whole ineffective, we urge that the Agencies preserve them in their entirety.

We elaborate here on two provisions in particular: (1) determination of the borrower's ability to repay the loan by analyzing the borrower's inflows and outflows; and (2) the limit on the number of loans that may be made.

B. Requiring determination of the borrower's ability to repay the loan is necessary and appropriate.

1. Analyzing inflows and outflows is necessary, as the data clearly indicate that assessment of inflows alone results in high numbers of repeat loans.

Payday lenders, including banks making payday loans, have typically approved loans based on the expectation that the borrower's gross inflows on payday, or upon receipt of public benefits, will cover repayment of the loan.[126] While this approach often ensures the lender's ability to *collect* the loan proceeds, the data on repeat use make clear that this approach fails to ensure the borrower's ability to *repay* without reborrowing.

Thus, it is necessary and appropriate that the Agencies propose requiring that lenders analyze the borrower's inflows and outflows to determine ability to repay the loan without reborrowing. As the Agencies note, underwriting for other credit products typically entails this analysis.[127] The Agencies propose consideration of the customer's inflows and outflows over no less than the preceding six consecutive months. This is an appropriate time period and should be no less. The Agencies also emphasize that the bank consider the net surplus or deficit at the end of each month, without relying on a six-month average. This too is appropriate, as larger one-time inflows could significantly skew a six-month average that would not reflect the borrower's ongoing financial capacity.

[126] FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354.

[127] FDIC: 78 Fed. Reg. 25269; OCC: 78 Fed. Reg. 25354.

2. There is clear precedent for regulators and Congress requiring a determination of ability to repay.

Years of regulatory guidance, advisory letters, and rules, as well as a growing body of federal legislative precedent, explicitly require that a lender determine the borrower's ability to repay a loan, and that the determination be based on income and obligations.

As applicable to all loans, the 2001 Interagency Subprime Guidelines provide that loans to borrowers who do not "demonstrate" the capacity to repay are unsafe and unsound.[128] The OCC's 2003 letter addressing predatory and abusive lending states in strong terms that "disregard of basic principles of loan underwriting," which the OCC describes as failing to determine ability to repay, "lies at the heart of predatory lending."[129]

In the credit card context, the 2009 Credit Card Act explicitly required that lenders "consider[] the ability of the consumer to make the required payments under the terms" of the account.[130] The FRB interpreted this provision to require that the lender consider ability to repay "based on the consumer's income or assets *and* current obligations."[131]

In the mortgage context, since 1994, the Home Ownership and Equity Protection Act has prohibited making high-cost HOEPA loans without regard to the borrower's repayment ability,[132] "including the consumers' current and expected income, *current obligations*, and employment." In 2009, the FRB expanded this provision to a lower cost category of loans than "high-cost" loans, called "higher priced mortgages" (essentially subprime loans), and required verification of income, assets and obligations for both high-cost and higher-priced loans.[133] The 2010 Dodd-Frank Act extended an ability-to-repay requirement to all mortgage loans, requiring "a reasonable and good faith determination based on verified and documented information,"[134]

[128] Interagency Expanded Guidance for Subprime Lending Programs, 2001: "Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound."

[129] OCC 2003 Advisory Letter on Predatory and Abusive Lending.

[130] 15 U.S.C. 1665e.

[131] 12 CFR 226.51(a) (emphasis added).

[132] 15 U.S.C. 1639(h): Prohibition on extending credit without regard to payment ability of consumer. A creditor shall not engage in a pattern or practice of extending credit to consumers under [high-cost] mortgages . . . based on the consumers' collateral without regard to the consumers' repayment ability, including the consumers' current and expected income, current obligations, and employment."

[133] Federal Reserve System, Truth in Lending, Regulation Z; Final Rule, 73 Fed. Reg. 44522, 44546 (July 30, 2008).

[134] 15 U.S.C. 1639c(a)(1).

including, among other items, expected income, current obligations, debt-to-income ratio or residual income, and other financial resources other than the consumer's equity.[135]

Thus, explicitly requiring an ability-to-repay determination, and requiring that it be based on income and expenses, is consistent with a range of existing credit regulation.

C. Limiting the number of payday loans is necessary and appropriate.

As discussed earlier, payday lenders, including banks making payday loans, assert that these loans are intended for occasional use, but the data indicate they are used on a sustained basis. The regulators' proposal that these loans be limited, consistent with previous regulatory action, helps to ensure that these loans are provided as intended.

1. The limit of one loan per month and a full statement period between loans helps to ensure that loans are used as marketed—on an occasional basis.

As discussed in Part II, a payday loan made within a short period of repayment of another loan is effectively a renewal or a refinance. Thus, the Agencies' proposed limit of one loan per statement period and a break of one statement period is essentially a prohibition on renewals and refinances, consistent with regulatory precedent previously cited that advises against them. It also helps to ensure that loans are used as marketed—on an occasional basis.

To be effective, it is important that the provision limits loans to no more than one per statement period (typically, approximately one month) and that the period of the required break between loans be at least one statement period (again, approximately one month), as the Agencies propose. Further, we support the FDIC's clarification that this provision should be applied in combination with its existing indebtedness limit for payday loans (discussed in part IV.C.2. below) across all lenders, bank or non-bank, requiring that banks review customers' account activity to identify payday loan activity with other lenders.[136]

Most borrowers take out a payday loan to meet recurring expenses.[137] A recent Pew study found that 53% borrowed to pay "a regular expense, such as utilities, car payment, credit card bill, or prescription drugs;" 10% borrowed to pay mortgage or rent; and 5% borrowed for food and groceries.[138] As most recurring expenses are on a monthly billing cycle, a month is the minimum

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[135] 15 U.S.C. 1639c(a)(3).

[136] 78 Fed. Reg. 25272, n.22.

[137] The Pew Charitable Trusts, Safe Small-Dollar Loans Research Project, *Payday Lending in America: Who Borrows, Where They Borrow, and Why, available at* http://www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Payday_Lending_Report.pdf, at 14 (July 2012) (69% of the 450 borrowers surveyed took out their first loan to pay recurring expenses).

[138] *Id.*

period of time over which a borrower's ability to repay, and meet ongoing expenses, should be assessed.

Further, the experience at the state level demonstrates that renewal bans that allow a loan to be extended too soon after another is repaid are ineffective at stopping the cycle of debt.[139] Payday lenders often support these measures but routinely circumvent them by having borrowers pay off their loan and then take out another shortly thereafter. This process is termed a "back-to-back" transaction.[140] Because these types of transactions technically do involve paying off the loan, they are typically not considered renewals under state laws prohibiting renewals. Some state laws require a "cooling-off" period of a business day or two between each loan, or after a certain number of consecutive loans.[141] But this period is far too short to stop the cycle of debt.[142]

2. There is clear precedent for limiting the number of payday and other relatively short-term loans.

Regulatory precedent, including long-standing guidance by these Agencies which the current proposed guidance is intended to supplement, is consistent with limiting the number of payday loans a bank may make to a customer.

Eight years ago, the FDIC issued payday loan guidelines, applicable to loans made through bank partnerships with non-bank payday lenders and by banks directly,[143] advising: "When a customer has used payday loans more than three months in the past 12 months . . . an extension of a payday loan is not appropriate under such circumstances."[144] Assuming a typical loan term of approximately two weeks, this indebtedness limit equates to approximately six loans per year. Those guidelines also provided that lenders establish "appropriate 'cooling off' or waiting periods between the time a payday loan is repaid and another application is made."[145]

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[139] CRL, *Springing the Debt Trap*, n.42.

[140] The CFPB recently found that the majority of payday loans made to borrowers with seven or more loans over twelve months were nearly continuous, i.e., taken out shortly after the previous loan was repaid. CFPB Findings at 25. This is true even though most states limit technical renewals.

[141] States with cooling off provisions include Alabama, Florida, Illinois, Indiana, North Dakota, Ohio, and Oklahoma.

[142] The Department of Defense's 2006 report addressing predatory lending highlighted that "[e]ven when the [payday loan] transactions are separated by a couple of days or a week, the borrower is still caught in the cycle of debt." U.S. Department of Defense, "Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents," Aug. 9, 2006, *available at* http://www.defense.gov/pubs/pdfs/report_to_congress_final.pdf.

[143] FDIC 2005 Payday Lending Guidelines ("Examiners should apply this guidance to banks with payday lending programs that the bank administers directly or that are administered by a third party contractor.").

[144] FDIC 2005 Payday Lending Guidelines.

[145] *Id.*

Thirteen years ago, the OCC's payday lending advisory letter advised: "[m]ultiple renewals—particularly renewals without a reduction in the principal balance, and renewals in which interest and fees are added to the principal balance, are an indication that a loan has been made without a reasonable expectation of repayment at maturity." It specifically advised that banks have no more than one payday loan outstanding to a borrower at any one time.[146]

When the National Credit Union Administration authorized small dollar loans at up to 28% APR in 2010, it explicitly limited these loans to three every six months, or six over a twelve-month period.[147]

D. The Agencies should preserve the other proposed underwriting-related provisions so that they are at least as strong as proposed.

The Agencies' proposal also includes requirements that the duration of the customer's relationship with the bank be sufficient to prudently underwrite the loan, no less than six months; that credit limits not be increased without a full underwriting reassessment and only upon request from the borrower; and that ongoing customer eligibility be reassessed no less than every six months, with a particular emphasis on repeat overdrafts and other credit obligations.[148] We support these requirements and urge that they be finalized at least as strong as proposed.

V. The Agencies should clarify that safe and sound banking principles require that interest and fees be reasonable, not to exceed 36 percent in annual percentage rate terms.

Cost is a critical element of any credit product, and bank payday loans are extraordinarily high-cost by any measure. Banks impose fees in the range of $7.50 to $10 per $100 borrowed for bank payday loans.[149] CRL's latest analysis of checking account data for the year 2011 found that the average bank payday loan term is 12 days—that is, the bank repays itself from the borrower's next direct deposit an average of 12 days after extending the credit.[150] The CFPB similarly found that the typical period during which a bank payday borrower had an outstanding advance balance was 12 days.[151]

[146] OCC 2000 Advisory Letter on Payday Lending.

[147] NCUA, Short-Term, Small Amount Loans, 75 Fed. Reg. 58285, 58287. The minimum loan term for these loans is one month.

[148] FDIC: 98 Fed. Reg. 25272 ; OCC: 98 Fed. Reg. 25357.

[149] While it continues to charge $10 per $100 borrowed, as it did in 2011, during a borrower's first year of payday loan use, Regions Bank. FRB-supervised, recently began charging $7 per $100 borrowed under certain circumstances for customers whose first Regions payday loan was taken out at least one year prior (Regions Ready Advance Account Agreement and Disclosures, 2013).

[150] CRL, *Triple Digit Danger*. The median loan term was found to be 12 days; the mean loan term was14 days.

[151] CFPB Findings at 28.

This cost and loan term translates to an annual percentage rate ranging from 225% to 300%, an extremely high cost for credit, particularly since the lender virtually guarantees repayment by putting itself first in line when a direct deposit hits the account.

The Agencies advise that fees be "based on safe and sound banking principles;" clearly, these loans' current costs are not. The Agencies do not, however, elaborate on what fee size is safe and sound. We urge the Agencies to be as explicit as the FDIC was in its 2007 Affordable Small Loan Guidelines, advising that loans not exceed an annualized interest rate of 36 percent, subject to more prescriptive restrictions under state law.[152] Even if banks continue to assert that their payday loans are open-end, they can measure the cost in annualized interest rate terms based on the average number of days their payday loans are outstanding, as the CFPB did in its discussion of deposit advance products in its recent white paper.[153]

VI. The Agencies should advise that banks not impose mandatory automatic repayment, particularly when repayment is triggered by the borrower's next deposit.

Banks typically require repayment of bank payday loans through electronic payment of the fee and the loan amount from the next direct deposit,[154] ensuring their own ability to collect the loan but not the borrower's ability to repay it. Indeed, relying on this "priority position," as the recently CFPB noted, creates a disincentive against ensuring the borrower has the ability to repay the loan without reborrowing.[155] It also denies the borrower the ability to make a measured decision about the order in which to pay debts and expenses.[156]

Mandatory automatic repayment runs counter to long-standing principles found in the Credit Practices Rule's prohibition on irrevocable wage assignments;[157] the Truth in Lending Act's protections against a lender offsetting outstanding balances on credit cards against the borrower's

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[152] For information on the history of, rationale for, and growing momentum for a 36% APR cap, *see* Lauren Saunders, *Why 36%: The History, Use, and Purpose of the 36% Interest Rate Cap*, National Consumer Law Center (April 2013), *available at* http://www.nclc.org/images/pdf/pr-reports/why36pct.pdf.

[153] CFPB Findings at 27-28.

[154] 78 Fed. Reg. 26268; OCC: 78 Fed. Reg. 26353.

[155] CFPB Findings at 44. *See also* National Consumer Law Center, *Stopping the Payday Loan Trap: Alternatives that Work, Ones That Don't* (June 2010), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf, at 15-17.

[156] *Id.* ("This position, in turn, trumps the consumer's ability to organize and prioritize payment of debts and other expenses.")

[157] 12 CFR 227.13 (Regulation AA).

deposits with that lender;[158] and Treasury's rule regarding delivery of Social Security benefits to prepaid debit cards.[159]

It also wholly undermines an intention of the EFTA, which prohibits creditors from conditioning an extension of credit on the consumer's repayment of that debt by "preauthorized electronic fund transfer."[160] Banks have ignored this prohibition as it technically applies to transfers authorized to recur at "substantially regular intervals," and bank payday loans are nominally structured as single-payment loans.

In light of the safety and soundness and consumer protection implications of requiring mandatory automatic repayment, the Agencies should prohibit banks from doing so, regardless of whether the loan is recurring or single-payment, and particularly when that repayment is triggered by the borrower's deposit.

VII. The Agencies should perform prompt and vigilant examination and enforcement.

The Agencies caution that they will take "appropriate supervisory action" to address unsafe and unsound practices associated with bank payday lending and to prevent harm to consumers they cause.[161] Given the small number of banks making payday loans, the Agencies should be able to promptly and thoroughly examine banks' compliance with this guidance. They should vigilantly assess compliance with the underwriting and related requirements and take swift enforcement action if necessary. The Agencies should also continue to watch closely for any potential new entrants into the high-cost payday lending market.

VIII. The Agencies should work with the CFPB to encourage strengthening existing consumer financial regulations.

A. Cost of credit disclosures under the Truth in Lending Act should allow for meaningful comparison across products.

Bank payday loans currently carry no annual percentage rate (APR) disclosure because banks classify their loans as "open-end" credit, even though the due date for the loan is fixed as the next deposit date or, at the latest, 35 days.[162] This omission limits consumers' ability to compare the cost of a bank payday loan to other forms of credit that do require APRs, including credit card purchases, credit card cash advances, overdraft lines of credit, and other small dollar loans.

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[158] 15 U.S.C § 1666h.

[159] 75 Fed. Reg. at 80338. *See also* Part III.E.3, *supra*.

[160] 15 U.S.C. § 1693k; Reg. E, 12 C.F.R. § 205.10(e)(1). That ban applies to transfers from one account to another account at the same institution, even though such transfers are otherwise outside of the scope of the EFTA.

[161] FDIC: 98 Fed. Reg. 25271; OCC: 98 Fed. Reg. 25356.

[162] Some bank payday loan products may carry a double-digit APR disclosure of, e.g., 21 percent, in addition to the fee per $100, but by far the most substantial portion of the cost is the fee charged per dollar borrowed.

It also encourages banks to disclose pricing that may appear cheaper than it is (e.g., $1 per $10 borrowed) or that is likely to mislead consumers in comparisons to other products (e.g., 10% of the amount borrowed). This is inconsistent with the principle of transparency so critical in credit markets, and the Agencies should work with CFPB to address it.

B. The Electronic Fund Transfer Act should ensure that lenders cannot require automatic repayment as a condition of receiving a loan.

As discussed earlier, a technicality has thus far allowed banks to skirt the protections against mandatory automatic repayment intended by the EFTA. The Agencies should work with CFPB to close the loophole in EFTA that has both encouraged lenders to require mandatory automatic repayment for single-payment loans and, conversely, encouraged lenders to make single-payment loans rather than installment loans. Together, the agencies should ensure that the law provides borrowers the ability to make a meaningful decision about the order in which to repay debts and other expenses.

Conclusion

The need for strong regulatory action is certain: The data make clear that banks are lending without regard to ability to repay, and regulatory precedent makes clear that lending without regard to ability to repay is unsafe, unsound, and harmful to banks' customers.

The work of the Agencies has been instrumental in temporarily curbing the spread of bank payday lending. But clarity in the marketplace is needed. The current proposed guidance, which provides clear underwriting expectations and limits on repeat loans, is critical to stop the cycle of debt at banks making these loans and to ensure that no additional supervisees begin trapping borrowers in payday loans going forward. For the Agencies to do less would increase safety and soundness risk at the banks the Agencies supervise and harm the customers whose deposits those banks hold.

We thank you for your responsiveness to this critical issue. Please do not hesitate to contact us if you have any questions about our comments.

APPENDIX

Every bank we know of making payday loans tells customers the product is intended for short-term rather than long-term use:

OCC-supervised:

Wells Fargo Bank: "The Direct Deposit Advance service may be helpful if you are experiencing a financial emergency and need money on a short-term basis . . . . Advances are intended to assist with short-term cash needs and are not recommended as a solution for your long-term financial needs."[163]

US Bank: "Checking Account Advance is a loan product designed for short-term credit needs. We do not recommend ongoing use of the Checking Account Advance service."[164]

Bank of Oklahoma: "The service is designed to help our customers meet their short-term borrowing needs, but is not intended to provide a solution for longer-term financial needs."[165]

Guaranty Bank: "This service . . . is designed to help our customers meet their short term needs and is not intended to provide a solution for longer-term financial needs or recurring expenses that you can plan for."[166]

FRB-supervised:

Fifth Third Bank: "[Early Access is a] line of credit used to assist our customers with short-term, financial emergencies or unexpected financial needs."[167]

Regions Bank: "Ready Advance is an open-end credit plan that is designed to provide you with funds when you have an emergency or other unexpected expense. Ready Advance is not intended for customers who need to repay an extension of credit over an extended period of time. Ready Advance should not be used for planned purchases, discretionary spending, or regular monthly expenses."[168]

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[163] Wells Fargo Direct Deposit Advance Service Agreement and Product Guide, Effective May 14, 2012 with Addenda effective January 29, 2012; July 15, 2012; and October 22, 2012 at 4, *available at* https://www.wellsfargo.com/downloads/pdf/checking/dda/termsandconditions_english.pdf.

[164] U.S. Bank Checking Account Advance, Summary of Key Features, https://www.usbank.com/checking/caa/agreement.html (last visited February 26, 2013).

[165] Fast Loan Terms and Conditions, 2011, *available at* https://www.bankofoklahoma.com/sites/Bank-Of-Oklahoma/asset/en/theme/default/PDF/Bank%20of%20Oklahoma%20FastLoanSM%20Terms%20and%20Conditions.pdf (last visited February 25, 2013).

[166] Guaranty Bank Easy Advance Line of Credit Agreement and Disclosures, as of December 12, 2012, *available at* http://www.guarantybanking.com/ContentDocumentHandler.ashx?documentId=183421.

[167] Fifth Third Early Access, Summary of Key Features, https://www.53.com/doc/pe/pe-eax-tc.pdf (last visited February 26, 2013).

[168] Regions Ready Advance Account Agreement and Disclosures, http://www.regions.com/personal_banking/ready_advance_tc.rf (last visited February 26, 2013).

Exhibit E

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, DC 20429

OFFICE OF THE CHAIRMAN

May 29, 2012

Ms. Lisa Donner
Executive Director
Americans for Financial Reform
1629 K Street, NW, 10th Floor
Washington, D.C. 20006

Dear Ms. Donner:

Thank you for your February 22, 2012 letter in which your coalition, along with more than 200 other interested organizations and individuals, expressed concerns about banks that are making deposit "advance" loans that are structured like loans from payday loan stores. In your letter, you highlighted that payday lending by banks undermines state law in states that have prohibited or imposed limitations on payday loans as well as provisions of the Military Lending Act aimed at protecting service members from payday loans. Your letter further expresses concerns about a major software system provider that is actively marketing a bank payday software product. The software product is reportedly experiencing strong growth and is being marketed as a tool banks can use to boost revenue.

The FDIC is deeply concerned about these continued reports of banks engaging in payday lending and the expansion of payday lending activities under third-party arrangements. Typically, these loans are characterized by small-dollar, unsecured lending to borrowers who are experiencing cash-flow difficulties and have few alternative borrowing sources. The loans usually involve high fees relative to the size of the loan and, when used frequently or for long periods, the total costs to the borrower can rapidly exceed the amount borrowed.

In 2005 and 2007 the FDIC released guidance designed to limit bank payday lending and to encourage banks to offer affordable small dollar loans.[1] As your letter highlights, however, banks continue to engage in high-cost payday lending activities and such activities appear to be on the rise.

Consequently, I have asked the FDIC's Division of Depositor and Consumer Protection to make it a priority to investigate reports of banks engaging in payday lending and recommend further steps by the FDIC. We would welcome your input on this issue.

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[1] See *Guidelines for Payday Lending, FIL-14-2005 and Affordable Small-Dollar Loan Guidelines FIL-50-2007).*

Thank you again for sharing your concerns regarding payday lending with me. If you have any questions, please do not hesitate to contact my Chief of Staff, Barbara Ryan, at 202-898-3841.

Sincerely,

Martin J. Gruenberg

Martin J. Gruenberg
Acting Chairman

Exhibit F

Office of Inspector General

June 2006
Report No. 06-011

Challenges and FDIC Efforts Related to Predatory Lending

AUDIT REPORT

Office of Audits

oig

Office of Audits

oig

Report No. 06-011
June 2006

Challenges and FDIC Efforts Related to Predatory Lending

Background and Purpose of Audit

Predatory lending typically involves imposing unfair and abusive loan terms on borrowers, and statistics show that borrowers lose more than $25 billion annually due to predatory practices. Predatory lending can be detrimental to consumers and increases the financial and reputation risk for financial institutions. Characteristics potentially associated with predatory lending include, but are not limited to, (1) abusive collection practices, (2) balloon payments with unrealistic repayment terms, (3) equity stripping associated with repeat refinancing and excessive fees, and (4) excessive interest rates that may involve steering a borrower to a higher-cost loan.

The FDIC is responsible for evaluating FDIC-supervised financial institutions' compliance with federal consumer protection laws and regulations, including several that address predatory lending. To evaluate compliance, the FDIC conducts examinations of institutional practices regarding fair lending, privacy, and other consumer protection laws.

The objective of this audit was to determine the challenges faced and the efforts taken by the FDIC to identify, assess, and address the risks posed to FDIC-supervised financial institutions and consumers from predatory lending practices. We also gained an understanding of the efforts taken by the other federal banking regulators to address predatory lending.

To view the full report, go to www.fdicig.gov/2006reports.asp

Results of Audit

The FDIC faces significant challenges associated with identifying, assessing, and addressing the risks posed to FDIC-supervised institutions and consumers by predatory lending. Specifically, (1) each loan transaction must be viewed in its totality to determine whether it may be predatory; (2) FDIC-supervised institutions can have direct or indirect involvement in predatory lending; and (3) nontraditional mortgages and other loan products are now available that contain terms that may be viewed as appropriate for some borrowers, but predatory for others. Further, the FDIC must ensure that its efforts to combat predatory lending do not limit consumer access to legitimate sources of credit.

FDIC guidance issued to examiners, FDIC-supervised financial institutions, and consumers addresses predatory lending. However, the guidance does not formally articulate a supervisory approach to address predatory lending and was not issued for the explicit purpose of identifying, assessing, and addressing the risks that such lending practices pose to institutions and consumers. Further, certain characteristics potentially indicative of predatory lending were not covered. The lack of an articulated supervisory approach and gaps in coverage could result in increased risk that predatory lending practices occur, are not detected, and harm institutions and consumers.

Recommendations and Management Response

The report recommends that the FDIC describe in policy its overall approach to addressing predatory lending and review existing examiner, financial institution, and consumer guidance and determine whether additional guidance is needed to address the risks associated with predatory lending. Additionally, the report identifies for the FDIC's consideration other federal banking regulatory agencies' actions to identify, assess, and address predatory lending.

FDIC management agreed with the recommendations. The FDIC will develop an overall supervisory approach to predatory lending that will include a review of existing supervisory policies and practices. Based on that review, the Corporation will also develop additional guidance to address predatory lending, if necessary.

TABLE OF CONTENTS

TABLES

ACRONYMS

AMTPA	**Alternative Mortgage Transaction Parity Act**
ANPR	**Advance Notice of Proposed Rulemaking**
ARM	**Adjustable Rate Mortgage**
CRA	**Community Reinvestment Act**
CRC	**Consumer Response Center**
DSC	**Division of Supervision and Consumer Protection**
ECOA	**Equal Credit Opportunity Act**
ED	**Examination Documentation**
FCRA	**Fair Credit Reporting Act**
FDCPA	**Fair Debt Collection Practices Act**
FFIEC	**Federal Financial Institutions Examination Council**
FHA	**Fair Housing Act**
FIL	**Financial Institution Letter**
FRB	**Federal Reserve Board**
FTC	**Federal Trade Commission**
GAO	**Government Accountability Office**
GLBA	**Gramm-Leach-Bliley Act**
HOEPA	**Home Ownership and Equity Protection Act**
HUD	**Department of Housing and Urban Development**
NCUA	**National Credit Union Administration**
OCC	**Office of the Comptroller of the Currency**
OIG	**Office of Inspector General**
OTS	**Office of Thrift Supervision**
RESPA	**Real Estate Settlement Procedures Act**
ROE	**Report of Examination**
TILA	**Truth in Lending Act**

FDIC
Federal Deposit Insurance Corporation
3501 Fairfax Drive, Arlington, VA 22226

Office of Audits
Office of Inspector General

DATE: June 7, 2006

MEMORANDUM TO: Sandra L. Thompson, Acting Director
Division of Supervision and Consumer Protection

FROM: Russell A. Rau [Electronically produced version; original signed by Russell A. Rau]
Assistant Inspector General for Audits

SUBJECT: *Challenges and FDIC Efforts Related to Predatory Lending*
(Report No. 06-011)

This report presents the results of the subject FDIC Office of Inspector General's (OIG) audit. Although there is no universally accepted definition, predatory lending typically involves imposing unfair and abusive loan terms on borrowers, often through aggressive sales tactics; taking advantage of borrowers' lack of understanding of complicated transactions; and outright deception. The objective of this audit was to determine the challenges faced and efforts taken by the FDIC to identify, assess, and address the risks posed to institutions and consumers from predatory lending. Also, we gained an understanding of the efforts taken to address predatory lending by the Office of Thrift Supervision (OTS), Office of the Comptroller of the Currency (OCC), Federal Reserve Board (FRB), Federal Trade Commission (FTC), and Department of Housing and Urban Development (HUD). Appendix I of this report discusses our objective, scope, and methodology in detail.

BACKGROUND

According to the Center for Responsible Lending, which is a research and policy organization whose main components include legislative and policy advocacy, borrowers lose more than $25 billion annually due to predatory mortgages, payday loans, and lending abuses involving overdraft loans, excessive credit card debt, and tax refund loans. Predatory lending can be detrimental not only to consumers but also to financial institutions because such practices could (1) lead to a high volume of foreclosures, which are costly to the mortgage holder; (2) undermine the reputation of financial institutions and the public's trust in the financial services industry; and (3) subject institutions that engage in or unintentionally support predatory lending to the risk of costly litigation.

Within the FDIC, the Division of Supervision and Consumer Protection (DSC) has primary responsibility for dealing with issues related to predatory lending. DSC addresses predatory lending and the effect that such lending might have on institutions and consumers as part of its safety and soundness and compliance examinations. For example, DSC examiners evaluate an institution's compliance with various consumer protection, fair lending, and privacy laws, including the following that address predatory, unfair, abusive, or deceptive acts or practices. (See Appendix II for more details.)

- Equal Credit Opportunity Act (ECOA)
- Fair Credit Reporting Act (FCRA)
- Fair Debt Collection Practices Act (FDCPA)
- Fair Housing Act (FHA)
- Federal Trade Commission Act (FTC Act)
- Home Ownership and Equity Protection Act (HOEPA)
- Real Estate Settlement Procedures Act (RESPA)
- Truth in Lending Act (TILA)

DSC has issued guidance to examiners, financial institutions, and consumers regarding issues related to predatory, unfair, abusive, or deceptive acts or practices. Further, the FDIC's national Consumer Response Center (CRC), established in July 2002, receives, investigates, and responds to complaints involving FDIC-supervised institutions and answers inquiries from consumers about consumer protection laws and banking practices. For the period January 1, 2003 through November 7, 2005, CRC identified 23 possible predatory lending complaints and inquiries. In response, CRC investigated or referred complaints to the responsible federal banking regulator as deemed appropriate, or otherwise disposed of the complaints. More specifically:

- eight complaints were investigated by the FDIC, and no evidence was found that the financial institution violated a consumer protection law or regulation;

- seven complaints were referred to other agencies because those circumstances did not involve FDIC-supervised institutions;

- four inquiries were information requests from consumers about payday or predatory lending;

- two complaints were investigated by the FDIC, and the Corporation did not intervene due to litigation between the consumer and the financial institution; and

- two complaints were not investigated by the FDIC because the consumer did not provide enough information about the nature of the complaint.

RESULTS OF AUDIT

Overall, we found that the FDIC faces significant challenges associated with identifying, assessing, and addressing the risks posed to FDIC-supervised institutions and consumers by predatory lending. Specifically, (1) each loan transaction must be viewed in its totality to determine whether it may be predatory; (2) FDIC-supervised institutions can have direct or indirect involvement in predatory lending; and (3) nontraditional mortgages and other loan products are now available that contain terms that may be viewed as appropriate for some borrowers but predatory for others. Further, the FDIC must ensure that its efforts to combat predatory lending do not limit consumer access to legitimate sources of credit.

FDIC guidance issued to examiners, FDIC-supervised financial institutions, and consumers addresses predatory lending. However, the guidance does not formally articulate a supervisory approach to address predatory lending and was not issued for the explicit purpose of identifying, assessing, and addressing the risks that such lending practices pose to institutions and consumers. Further, certain characteristics potentially indicative of predatory lending were not covered. The lack of an articulated supervisory approach and gaps in coverage could result in increased risk that predatory lending practices occur, are not detected, and harm institutions and consumers. Therefore, the FDIC needs to clarify for examiners and institutions its overall approach to addressing predatory lending and enhance guidance to bring increased attention to associated characteristics.

Additionally, this report identifies for the FDIC's consideration other federal banking regulatory agencies' actions to identify, assess, and address predatory lending.

CHALLENGES RELATED TO PREDATORY LENDING

The following discusses in detail significant challenges that the FDIC faces with respect to combating predatory lending.

Transactions Must be Viewed in Totality

Identifying or recognizing predatory lending in a specific loan transaction can be a challenge because each loan transaction must be viewed in its totality, including the associated marketing practices, terms of the agreement, various parties involved in the loan transaction, and financial sophistication of the parties involved. As a result, there is no simple "checklist" to follow in identifying predatory lending.

Additionally, borrowers can be susceptible to predatory lending practices in several phases of the loan transaction as described below.

- Marketing Phase. Lenders may employ aggressive marketing techniques that target specific borrowers or communities.

- Loan Underwriting Phase. Lenders may require borrowers to pay additional fees or accept additional and unnecessary services or products in order to receive a loan.

- Loan Execution Phase. Lenders may suggest refinancing, or "flipping" a loan (at an additional fee) without economic gain for the borrower.

When used in an unfair, abusive, or deceptive manner and depending on the circumstances faced by the specific borrower and the borrower's financial sophistication, the activities could, in fact, be predatory.

Direct or Indirect Institutional Involvement

A financial institution's involvement in predatory lending is not always obvious because such involvement may be direct or indirect. Direct involvement might involve a financial institution extending predatory loans to borrowers or using a network of loan brokers that have access to subprime lenders. A financial institution's indirect involvement in the predatory lending process—knowingly or unknowingly—may result from acquiring or forming subsidiaries that specialize in subprime lending, lending to subprime lenders, servicing loans, investing in asset-backed securities, or participating in the securitization process. Accordingly, determining an institution's involvement in predatory lending is difficult for FDIC examiners.

Variety of Loan Products

The fixed-rate mortgage is now just one of an array of loan products. Such loan products include: (1) no-money-down loans; (2) adjustable rate mortgages (ARM) with negative amortization and interest-only options; and (3) Option-ARMs, which give borrowers increased options in repaying the mortgage. Regulatory experience with nontraditional mortgage lending programs has shown that prudent management of these programs requires increased attention to product development, underwriting, compliance, and risk-management functions. Further, although these loan products may be appropriate for certain consumers, the federal regulatory agencies are concerned that these products and practices are being offered to some borrowers who may not otherwise qualify for traditional fixed-rate or ARM loans and may not fully understand the associated risks.

Maintaining Consumer Access to Credit

It has been widely recognized that there is a close relationship between predatory lending—which is detrimental to the consumer—and subprime lending—which has a legitimate place in the financial services industry, in that subprime lending serves the market of borrowers whose credit histories would not permit them to qualify for a conventional "prime" loan. This challenge is evidenced in testimony by the Comptroller of the Currency before the Committee on Banking and Financial Services, U.S. House of Representatives, May 24, 2000:

> While we clearly need to address real abuses that exist, particularly in connection with home-secured loans, we also need to preserve and encourage consumer access to credit, meaningful consumer choice, and competition in the provision of financial services to low- and moderate-income families. Determining how to draw the line between predatory and legitimate credit practices in a way that will both combat abuses and advance these other objectives is a major challenge.

Further, as many as 12 million households either have no relationship with traditional financial institutions or depend on "fringe lenders," such as pawnshops, payday lenders, and rent-to-own stores, for their credit needs. Such fringe lenders, which remain largely unregulated, frequently charge excessively high fees and can expose borrowers to predatory, unfair, abusive, or deceptive acts or practices.[1]

Thus, in combating predatory lending, the FDIC's challenge lies in preventing the unintended consequence of limiting consumer access to legitimate credit sources.

FDIC EFFORTS TO ADDRESS PREDATORY LENDING CHALLENGES

The FDIC has taken action to address significant challenges related to predatory lending by providing guidance in various forms to examiners, FDIC-supervised institutions, and consumers. However, the guidance does not formally articulate the Corporation's overall supervisory approach for addressing predatory lending and is contained in multiple policies, procedures, and memoranda. Generally, this guidance was not issued for the explicit purpose of addressing predatory lending. In addition, the guidance covers many, but not all, of the characteristics often associated with predatory lending. Consequently, predatory lending may not receive sufficient attention, which increases the risk that such practices could occur, may not be detected, and may harm institutions and borrowers.

FDIC Guidance Related to Predatory Lending

The FDIC has provided guidance related to predatory lending to examiners in safety and soundness and compliance examination policies and procedures and Regional Directors Memoranda and to institutions the FDIC supervises in financial institution letters (FIL).[2] The FDIC has also provided guidance to consumers on predatory lending through its adult education program—*Money Smart*—and the *FDIC Consumer News* publication. However, we found that the FDIC's guidance did not articulate the overall supervisory approach for identifying, assessing, and addressing predatory lending and either varied or did not explicitly cover some predatory lending characteristics, depending on the source of the guidance.

Numerous lending characteristics, when considered either individually or in combination, could indicate whether predatory lending has occurred. Our research identified 21 characteristics that are potentially associated with predatory lending. Some of these characteristics are not prohibited by law, but may be predatory if they are determined to be associated with unfair, abusive, or deceptive lending practices. Table 1 shows the characteristics identified by our research and indicates whether there is some coverage in established FDIC guidance.

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[1] FDIC Banking Review, 2005, Volume 17, No. 1, *Limited-Purpose Banks: Their Specialties, Performance, and Prospects.*

[2] FILs may announce new regulations, special alerts concerning entities operating illegally as financial institutions, new FDIC publications, or a variety of other matters.

Table 1: OIG Analysis of Coverage for Characteristics Potentially Associated With Predatory Lending[a]

Characteristic	Examination Guidance[b]		FILs	*Money Smart*
	Safety and Soundness	Compliance		
The "✓" indicates that guidance included some coverage of the characteristic.				
Abusive Collection Practices	✓	✓	✓	✓
Balloon Payments With Unrealistic Repayment Terms		✓	✓	✓
Encouragement of Default in Connection With Refinancing				
Equity Stripping Associated With Repeat Refinancing and Excessive Fees			✓	✓
Excessive Fees not Justified by the Costs of Services Provided and the Credit and Interest Rate Risks Involved	✓	✓	✓	✓
Excessive Interest Rates That May Involve "Steering" a Borrower to a Higher-Cost Loan	✓	✓	✓	✓
Fraud, Deception, and Abuse	✓	✓	✓	✓
High Loan-to-Value Ratio That May Negatively Impact a Borrower's Ability to Avoid Unaffordable Debt	✓		✓	✓
Lending Without Regard to Ability to Repay	✓	✓	✓	✓
Loan Flipping Without Economic Gain for the Borrower, Resulting in Equity Stripping	✓	✓	✓	✓
Mandatory Arbitration Clauses			✓	
Payday Lending	✓	✓	✓	✓
Pre-payment Penalties That May Trap Borrowers in High-Cost Loans		✓	✓	✓
Refinancing of Special Mortgages Without Economic Gain for the Borrower, Resulting in Equity Stripping				
Refinancing Unsecured Debt Without Economic Gain for the Borrower, Resulting in Equity Stripping				
Repetitive Refinancing Without Economic Gain for the Borrower, Resulting in Equity Stripping		✓	✓	✓
Single-Premium Credit Insurance That is Added to the Total Loan Amount and Increases the Total Interest Paid		✓	✓	✓
Spurious Open-End Loans		✓	✓	
Steering Borrowers Who Qualify for Lower-Cost Loans to Higher-Cost Financing			✓	
Subprime Lending Within Which Predatory Lending Generally Occurs[c]	✓	✓	✓	✓
Yield-Spread Premiums With Incentives to Steer Borrowers into Higher-Cost Loans		✓	✓	

Source: OIG review of DSC guidance provided to examiners, FDIC-supervised financial institutions, and consumers.

[a] Appendix III provides details on the characteristics that may be predatory if they are determined to be associated with unfair, abusive, or deceptive lending practices.

[b] Examination guidance includes examination policies, procedures, and Regional Directors Memoranda.

[c] According to the DSC *Risk Management Manual of Examination Policies*, there is not a universal definition of a subprime loan in the industry, but subprime lending is generally characterized as a lending program or strategy that targets borrowers who pose a significantly higher risk of default than traditional retail banking customers.

Coverage of the lending characteristics in Table 1 can vary depending on their nature, and certain characteristics may appropriately lend themselves to being covered under one type of examination (e.g., safety and soundness or compliance) in comparison to another. As a result, we fully recognize that there may be legitimate reasons why certain characteristics may not be included in a particular form of guidance. However, three of the characteristics were not explicitly covered by any of the guidance—specifically, (1) encouragement of default, (2) refinancing of special mortgages, and (3) refinancing unsecured debt.

There may be other lending characteristics associated with predatory lending practices that are not included in Table 1. Further, we recognize that defining lending practices that constitute predatory lending is not easy and that consideration must be given to the context in which lending practices occur. Some lending practices may be abusive in the context of high-cost loans; others may be unacceptable in all contexts; and others, not necessarily abusive for all high-cost borrowers, may be abusive for a particular borrower due to deception. We discuss, in detail, coverage of the characteristics by the various forms of FDIC guidance in the following sections of the report.

Guidance to FDIC Examiners

The FDIC conducts and provides guidance on examinations to determine the safety and soundness of financial institutions and whether institutions are complying with consumer protection laws and regulations. DSC's examination guidance does not articulate the FDIC's overall supervisory approach for addressing predatory lending. Further, the FDIC's safety and soundness examination and compliance examination guidance addresses many, but not all of the potentially predatory lending characteristics that our research identified.

Safety and Soundness Examination Guidance

We found that DSC's safety and soundness examination guidance covered the following characteristics.

Subprime Lending Examination Documentation (ED) Module

- Abusive collection practices.
- Excessive fees not justified by the costs of services provided and the credit and interest rate risks involved.
- Excessive interest rates that may involve "steering" a borrower to a higher-cost loan.
- Fraud, deception, and abuse.
- Lending without regard to ability to repay.
- Loan flipping without economic gain for the borrower, resulting in equity stripping.

- Subprime lending within which predatory lending generally occurs.

Residential Real Estate Lending ED Module

- High loan-to-value ratio that may negatively impact a borrower's ability to avoid unaffordable debt.

Payday Lending Guidance

- Payday lending (a particular type of subprime lending) guidance also includes guidance on lending without regard to the ability to repay and information on various consumer protection laws, including the TILA, ECOA, FCRA, FDCPA, and FTC Act.[3]

As of September 30, 2005, the FDIC reported 91 (about 2 percent) of the 5,257 FDIC-supervised institutions as subprime lenders based on aggregate credit exposure in subprime loans equal to or greater than 25 percent or more of Tier 1 capital. As a result, use of the *Subprime Lending ED Module* and coverage of the seven characteristics noted above could be limited to a small number of FDIC-supervised institutions.

In addition to the subprime, residential real estate, and payday lending guidance, we found that the *Mortgage Banking ED Module* does not specifically reference any of the characteristics but does contain the following step in the *Internal Controls* section of the segment entitled, *Core Analysis Procedures*, as shown below:

> Evaluate the bank's process for ensuring compliance with predatory lending laws, including:
>
> - the strategy for handling loans originated and serviced in various jurisdictions;
> - procedures to confirm compliance with predatory lending laws and regulations; and
> - risk controls that are in place to prevent predatory servicing practices.

The extent to which examiners would perform this step depends upon whether the financial institution being examined is classified as a mortgage banker. As of September 2005, the FDIC classified 376 (about 7 percent) of its supervised institutions as mortgage bankers, which are defined as institutions that deal in mortgages with brokers originating loans and then selling them to investors. Further, although the module directs examiners to evaluate the bank's procedures for confirming compliance with predatory lending laws and regulations, the module does not specify the laws and regulations the examiners should use to make the evaluation. However, DSC officials stated that the ED modules resulted from an interagency effort by the FDIC,

[3] The FDIC's subprime lending and payday lending guidance also provides information on the FDIC's expectations for prudent risk-management practices for those lending activities. At the time the FDIC released its payday lending guidance in March 2005, the Corporation reported that 12 FDIC-supervised institutions were engaging in payday lending.

Federal Reserve Board, and Conference of State Bank Supervisors and that because those procedures are used by state examiners and federal examiners, it is not practical for the module to document every applicable state and federal law and regulation. In addition, DSC officials stated that ED modules are an examination tool that focuses on risk management practices and guides examiners to establish the appropriate examination scope. In addition, the modules:

- incorporate questions and points of consideration into examination procedures to specifically address a bank's risk management strategies for each of its major business activities and

- direct examiners to consider areas of potential risk and associated risk control practices to facilitate an effective supervisory program.

Further, DSC officials stated that the Subprime Lending and Mortgage Banking ED Modules are supplemental modules or reference modules to be used in conjunction with core ED modules. Examiners are not required to duplicate efforts already addressed in core procedures or elsewhere, since ultimately, the conclusions will be brought forward to the Core Analysis Decision Factors.

The safety and soundness examination guidance did not cover the following characteristics:

- balloon payments with unrealistic repayment terms;
- encouragement of default in connection with refinancing;
- equity stripping associated with repeat refinancing and excessive fees;
- mandatory arbitration clauses;
- pre-payment penalties that may trap borrowers in high-cost loans;
- refinancing of special mortgages without economic gain for the borrower, resulting in equity stripping;
- refinancing unsecured debt without economic gain for the borrower, resulting in equity stripping;
- repetitive refinancing without economic gain for the borrower, resulting in equity stripping;
- single-premium credit insurance that is added to the total loan amount and increases the total interest paid;
- spurious open-end loans;
- steering of borrowers who qualify for lower-cost loans to higher-cost financing; and

- yield-spread premiums with incentives to steer borrowers into higher-cost loans.

Lacking coverage of certain characteristics could be significant because predatory lending may cause safety and soundness problems. For example:

- **Balloon Payments With Unrealistic Repayment Terms.** A financial institution may structure loans with initial low monthly payments but include a balloon payment that the borrower cannot afford in an attempt to trap the borrower into refinancing and paying additional fees at the end of the loan term. However, if the borrower is unable to restructure the loan and the collateral value declines, the institution is left without adequate sources of repayment for the loan. Higher loan losses could lead to safety and soundness concerns.

- **Refinancing Unsecured Debt Without Economic Gain for the Borrower, Resulting in Equity Stripping.** A financial institution that engages in refinancing unsecured debt, using a borrower's home as collateral, may eventually incur higher loan losses. Borrowers may continue to incur additional unsecured debt and may default on the loan. If a borrower defaults, the institution is dependent upon the collateral for any recovery on the loan. The bank would absorb foreclosure costs and any decline in collateral value. An institution that makes a loan to a consumer based predominantly on the liquidation value of the borrower's collateral, rather than on determination of the borrower's repayment ability, may be engaging in a fundamentally unsafe and unsound banking practice. This practice increases not only the risk to the bank that the loan will default but also the bank's potential loss exposure upon default.

Compliance Examination Guidance

Compliance examination procedures include guidance for examiner use in determining compliance with a number of consumer protection laws and regulations, including HOEPA, TILA, RESPA, and the FTC Act. Examiners use these procedures if the examiner decides, through the risk-focused compliance examination process, to test the bank's compliance with a particular law or regulation. Noncompliance can result in civil liability and negative publicity as well as the FDIC's imposition of formal or informal actions to correct noncompliance. Further, it is important to note that the FDIC can rely on the FTC Act as authority for issuing enforcement actions against financial institutions for unfair, abusive, and deceptive acts or practices, which could include any or all of the characteristics potentially associated with predatory lending that our research identified.

The FDIC's compliance examination procedures include reference to many of the characteristics that we identified in conducting the audit but do not cover the following:

- encouragement of default in connection with refinancing;

- equity stripping associated with repeat refinancing and excessive fees;

- high loan-to-value ratio that may negatively impact a borrower's ability to avoid unaffordable debt;

- mandatory arbitration clauses;

- refinancing of special mortgages without economic gain for the borrower, resulting in equity stripping;

- refinancing unsecured debt without economic gain for the borrower, resulting in equity stripping; and

- steering of borrowers who qualify for lower-cost loans to higher-cost financing.

Further, of those characteristics, neither the compliance nor safety and soundness examination guidance covered: (1) encouragement of default in connection with refinancing; (2) equity stripping associated with repeat refinancing and excessive fees; (3) mandatory arbitration clauses; (4) refinancing of special mortgages without economic gain for the borrower, resulting in equity stripping; (5) refinancing unsecured debt without economic gain for the borrower, resulting in equity stripping; and (6) steering of borrowers who qualify for lower-cost loans to higher-cost financing. These characteristics could cause detrimental consequences such as defaults and foreclosures to borrowers. Although we did not identify specific coverage of the seven characteristics in compliance examination guidance, as noted earlier, those characteristics could indicate noncompliance with the FTC Act if the loan was made in an unfair, abusive, or deceptive manner.

On June 17, 2005, the FDIC issued examination guidance entitled, *Procedures for Determining Compliance With the Prohibition on Unfair and Deceptive Acts or Practices found in Section 5 of the Federal Trade Commission Act*. The purpose of that guidance is to strengthen the FDIC's ability to apply Section 5 of the FTC Act, which prohibits such acts or practices. In addition, although examination guidance states that most banking organizations do not engage in unfair or deceptive acts or practices, advances in banking technology and changes in the lending organizational structure have contributed to financial institutions' participating in non-banking activities and provided the ability to structure complex financial products and sophisticated marketing methods. The pace and complexity of these advances have increased the potential risk for consumer harm. However, the examination guidance does not specifically address predatory lending practices.

Guidance to FDIC-Supervised Institutions

The FILs issued to FDIC-supervised institutions include information on all of the characteristics that we identified except for the following:

- encouragement of default in connection with refinancing;

- refinancing of special mortgages without economic gain for the borrower, resulting in equity stripping; and

- refinancing unsecured debt without economic gain for the borrower, resulting in equity stripping.

Encouragement of default may influence a borrower to breach an existing loan to subsequently refinance all or part of a loan, which could result in higher loan balances and additional interest and fees. In addition, encouraging a borrower to use equity in a residence as collateral to refinance unsecured debt, such as credit card debt, could jeopardize the borrower's equity in the residence and could, ultimately, result in the borrower losing the residence. Refinancing special mortgages could also negatively affect terms that may have been favorable to the borrower, leaving the borrower with loan terms that do not provide a tangible economic benefit.

Enhancing the FILs to cover these characteristics would help to ensure that financial institutions protect consumers by avoiding these practices, when appropriate.

Consumer Education

The FDIC has included information related to predatory lending in its adult education program—*Money Smart*—and its *FDIC Consumer News* publication. *Money Smart* includes information on many of the characteristics that we identified but does not include coverage of the following:

- encouragement of default in connection with refinancing;
- mandatory arbitration clauses;
- refinancing of special mortgages without economic gain for the borrower, resulting in equity stripping;
- refinancing unsecured debt without economic gain for the borrower, resulting in equity stripping;
- spurious open-end loans;
- steering of borrowers who qualify for lower-cost loans to higher-cost financing; and
- yield-spread premiums with incentives to steer borrowers into higher-cost loans.

The FDIC created *Money Smart* as a training program to help adults outside the financial mainstream enhance their financial management skills and create positive banking relationships. Ten comprehensive modules comprise the *Money Smart* curriculum and cover basic financial topics to help consumers understand banking basics. The modules include information on bank services, credit, budgeting, savings, credit cards, loans, and homeownership. The program also provides information in the following areas to assist consumers in avoiding predatory lending:

- loan payment decisions,
- loan rejection,

- predatory lending and TILA,
- predatory loan offers,
- predatory lending tactics, and
- what to do if consumers believe they are victims of a predatory loan.

Information on predatory lending also addresses mortgage loans, credit cards, and installment loans. The program is available through the Internet, classroom instruction, or CD-ROM and is available in multiple languages, including Spanish, Korean, Chinese, Vietnamese, and Russian.

The *FDIC Consumer News* provides practical guidance on how to become a smarter, safer user of financial services. The Summer 2002 edition of the *FDIC Consumer News* article entitled, *High-Cost "Predatory" Home Loans: How to Avoid the Traps*, advised consumers that:

> . . . something is robbing homeowners of money and putting many of these same families at risk of *losing* their homes. . . . There is no clear-cut definition of a predatory loan, but many experts agree that it is the result of a company misleading, tricking and sometimes coercing someone of taking out a home loan (typically a home equity loan or mortgage refinancing) at excessive costs and without regard to the homeowner's ability to repay. Victims who have trouble repaying a predatory loan often face harassing collection tactics or are encouraged to refinance the loan at even higher fees.

The publication also acknowledged some of the consumer protection laws, including TILA and HOEPA.

FDIC guidance to consumers could be enhanced to provide coverage on the seven characteristics not already addressed to make consumers better aware of the potential negative effects of predatory lending.

Conclusion and Recommendations

FDIC officials have stated that federally insured depository institutions have a good record of avoiding involvement in predatory lending practices. Those financial institutions, which are banks, thrifts, or credit unions, are subject to federal and state oversight and supervision, unlike most subprime lenders. Further, financial institutions' regulatory agencies have stated that their monitoring and examination activities have revealed little evidence of predatory lending practices by federally regulated depository institutions. However, as consumers enjoy more access to credit from a wider variety of sources, opportunities have expanded for predatory lending. Education is one way to help people achieve financial literacy and avoid abusive loans, but supervision and oversight should also play an important role in preventing predatory lending practices.

The FDIC has recognized the importance of its role in this regard by establishing a strategic goal to ensure that consumers' rights are protected and by responding to consumer complaints and inquiries related to predatory lending. The FDIC has also taken steps to provide guidance to its examiners, FDIC-supervised financial institutions, and consumers on many of the characteristics related to predatory lending. However, the Corporation could bring more attention to combating predatory lending by establishing and articulating its overall supervisory approach for identifying, assessing, and addressing the risks associated with predatory lending and ensuring that characteristics of predatory lending are addressed in examiner, institution, and consumer guidance.

We recommend that the Director, DSC:

(1) Describe in policy the FDIC's overall supervisory approach to predatory lending.

(2) Review existing examiner, financial institution, and consumer guidance and determine whether additional guidance is needed to address the risks associated with predatory lending.

ISSUES FOR CONSIDERATION

The FDIC and some members of the Federal Financial Institutions Examination Council (FFIEC)[4] have addressed predatory lending in various ways. These include jointly issued guidance, performance measurement, consumer information on predatory lending, and assessment of risk associated with predatory lending. Appendix IV contains supplemental information from some of the other federal banking regulatory agencies regarding their efforts related to predatory lending.

Jointly Issued Guidance

The FFIEC members have jointly issued guidance to examiners, financial institutions, and consumers on supervisory and consumer issues related to some predatory lending characteristics. For example, the FFIEC issued guidance and examination procedures on subprime lending in January 2001 and on fair lending in August 2004. Further, the FFIEC members issued guidance to consumers entitled, *Putting Your Home on the Loan Line is Risky Business*.[5] The brochure provides information on the following:

- Groups targeted by abusive lenders or contractors—homeowners with low incomes or credit problems and the elderly.

- Steps consumers can take to protect themselves, including:

    - considering multiple options for sources of credit;
    - contacting several lenders for possible credit;

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[4] The FFIEC, which consists of all federal financial institution regulatory agencies, is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions by the FDIC, OTS, OCC, FRB, and National Credit Union Administration (NCUA). The FFIEC makes recommendations to promote uniformity in the supervision of financial institutions. The scope of our audit did not include the NCUA.

[5] The following agencies also participated in the issuance of the consumer brochure: HUD, Department of Justice, Federal Housing Finance Board, FTC, and Office of Federal Housing Enterprise Oversight.

  - comparison shopping for loan terms, conditions, payment options, points, fees, and penalties; and
  - understanding consumer rights and cancellation options.

- Contact information for federal banking regulatory agencies, the Department of Justice, HUD, Federal Housing Finance Board, and Office of Federal Housing Enterprise Oversight.

In addition, in March 2004, the FDIC and FRB jointly published guidance for state-chartered institutions on unfair or deceptive acts or practices prohibited by Section 5 of the FTC Act. This guidance explains how institutions could avoid engaging in practices that might be viewed as unfair or deceptive.

Individual Regulatory Guidance

The individual members of the FFIEC have issued guidance to their examiners and supervised institutions.

<u>Office of Thrift Supervision Guidance</u>

OTS has issued examination-scoping guidance and a *Strategic Plan* that specifically addresses predatory lending. The OTS Examination Scope Worksheet, which examiners use to determine whether a specific issue should be included in the examination scope, includes a line item for an assessment of predatory lending issues. Further, the OTS *Strategic Plan* includes a performance goal to maintain a thrift industry that effectively complies with consumer protection laws. As stated in the plan, one of the strategies OTS uses for achieving performance is to "conduct examinations with a top-down, risk focused approach that promotes comprehensive compliance management including the establishment of adequate internal controls to ensure regulatory compliance and to avoid predatory practices."

<u>Office of the Comptroller of the Currency Guidance</u>

OCC has issued industry guidance addressing predatory lending.

- In February 2003, OCC issued two advisory letters related to predatory lending to the national banks and operating subsidiaries it supervises. The advisory letters:

  - describe loan attributes that are often considered predatory and establish standards for policies and procedures for monitoring loan transactions to avoid making, brokering, or purchasing loans with such attributes;

  - state OCC's position that predatory lending will affect a national bank's Community Reinvestment Act (CRA) rating;[6] and

[6] On July 19, 2005, the federal banking agencies approved CRA final rules, effective September 1, 2005. Those rules include clarification on when discrimination or other illegal credit practices by a bank or its affiliate will adversely affect an evaluation of the bank's CRA performance.

  - clarify ways in which predatory lending practices can create legal, safety and soundness, and reputational risks for national banks.

- In January 2004, OCC issued a rule adopting anti-predatory lending standards that expressly prohibit national banks from (1) making consumer and mortgage loans based predominantly on the bank's realization of the foreclosure value of the borrower's collateral, without regard for the borrower's ability to repay, and (2) engaging in unfair and deceptive practices within the meaning of Section 5 of the FTC Act.

- In September 2004, OCC issued an advisory letter alerting national banks regarding OCC's concerns about certain credit card marketing and account management practices. These practices may entail unfair or deceptive acts or practices and may expose a bank to compliance and reputational risks.

- In February 2005, OCC issued guidelines on national bank residential mortgage lending standards to further the OCC's goal of ensuring that national banks do not become involved in predatory, abusive, unfair, or deceptive residential mortgage lending practices. The guidelines are enforceable pursuant to the process provided in Section 39 of the FDI Act and Part 30 of OCC regulations. The new guidelines incorporated key elements of the OCC's February 2003 advisory letters.

Federal Reserve Board Guidance

The FRB has issued examination guidance on assessing financial institutions' risks related to predatory lending. FRB's *Risk-Focused Consumer Compliance Supervision Program*, dated December 2003, states that FRB examiners evaluate consumer compliance risks during specialized consumer compliance examinations. The consumer compliance risk profile incorporates an assessment of operational, legal, and reputational risks arising from a bank's consumer compliance activities.

In evaluating reputational risk during safety and soundness examinations, examiners are to determine whether the bank's risk is "low," "moderate," or "high" in accordance with FRB guidance. In addition, examiners assign a trend indicator of "increasing," "stable," or "decreasing." The risk assessment considers the (1) level of inherent risk involved in each of the bank's significant business activities and (2) strength of risk management systems in place to control the level of risk in these activities. Table 2 on the next page shows that FRB examiners consider the level of reputational risk specifically related to predatory lending for FRB-supervised financial institutions.

Table 2: Analysis of Reputational Risk for FRB-Supervised Financial Institutions

Reputational Risk		
Low	**Moderate**	**High**
Business strategy and/or bank products unlikely to raise concern regarding predatory lending and/or unfair and deceptive acts or practices.	Business strategy and/or bank products may raise concern regarding predatory lending and/or unfair and deceptive acts or practices.	Business strategy and/or bank products likely to raise serious concern regarding predatory lending and/or unfair and deceptive acts or practices.

Source: FRB *Risk-Focused Consumer Compliance Supervision Program*, dated December 2003.

Conclusion

It is not our intention to conclude on whether one agency's approach to addressing predatory lending is better than another. We recognize that the OCC and OTS supervisory approaches to predatory lending are based, in large part, on their authority to charter and supervise institutions whose operations are largely defined and bound by federal statutes and regulations. Unlike the OCC and OTS, the FDIC is not a chartering authority and shares regulatory oversight of the institutions it supervises with the appropriate state supervisor that can address predatory lending through applicable state and local laws and regulations. Nevertheless, the FDIC should consider the merits of the other federal banking regulatory agencies in establishing the Corporation's supervisory approach to this important issue. Additional information on OTS and OCC predatory lending efforts is in Appendix IV.

CORPORATION COMMENTS AND OIG EVALUATION

A draft of this report was issued on February 24, 2006. On June 1, 2006, the Acting Director, DSC, provided a written response to the draft report. The DSC response is presented in its entirety in Appendix V. A summary of management's response to the recommendations is in Appendix VI.

In its response to recommendations 1 and 2, DSC stated that it agreed with the recommendations and would develop an overall supervisory approach to predatory lending that will include a review of existing supervisory policies and practices. Based on that review, DSC will also develop additional enhanced guidance to address predatory lending, if necessary. DSC agreed to complete these actions by December 31, 2006. These agreed-upon actions meet the intent of our recommendations, which will remain open for reporting purposes until we have determined that the actions have been completed and are effective.

In addition to addressing the recommendations in the draft report, DSC's response provided an overview of its past and ongoing efforts to address predatory lending, including (1) examination guidance and training, (2) enforcement policy, (3) speeches and testimony, and (4) financial education.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

The overall objective of this audit was to determine the challenges faced and efforts taken by the FDIC to identify, assess, and address the risks posed to institutions and consumers from predatory lending. As part of this objective, we contacted other federal regulators to determine the policies, procedures, and guidance the banking regulators, FTC, and HUD had issued to address these risks. We performed our audit from April 2005 through January 2006 in accordance with generally accepted government auditing standards.

Scope and Methodology

To achieve the objective, we interviewed FDIC officials in:

- DSC's headquarters in Washington, D.C., responsible for conducting safety and soundness and compliance examinations of FDIC-supervised financial institutions.

- DSC's Kansas City Regional Office, CRC, responsible for investigating consumer complaints about FDIC-supervised institutions and for responding to consumer inquiries about consumer laws and regulations and banking practices. We obtained information on policies and procedures related to consumer complaints and inquiries and statistics on the number of complaints and inquiries received since 2003 that related to predatory lending.

- The Office of Ombudsman, which acts as a liaison for the banking industry and the general public, to facilitate the resolution of problems and complaints in a fair, impartial, and timely manner.

In addition, we reviewed:

- Prior audit reports and various articles related to predatory and subprime lending.

- FDIC regulations and DSC policies and procedures manuals, including related examination procedures for safety and soundness and compliance examinations; and FILs used to provide guidance and announce new regulations and special alerts to FDIC-supervised institutions.

- Literature and the training modules for, and performance measures related to, the FDIC's *Money Smart* program.

- The FDIC's *2005-2010 Strategic Plan*, *2005 Annual Performance Plan*, and the FDIC/DSC 2004 Business Line Objectives to determine whether the Corporation had developed performance measures related to consumer protection, in general, and predatory lending, in particular.

- Information obtained during interviews with other federal banking regulatory agencies, FTC, and HUD and those agencies' respective Web sites on:
  - examination policies and procedures and
  - information provided to examiners, financial institutions, and consumers.

During the audit, we coordinated with the other FDIC OIG Office of Audits directorates, Office of Investigations, and Office of Counsel and GAO to determine whether there were prior or ongoing audits, studies, or investigations related to predatory lending. Regarding congressional issues or interests related to predatory lending, we coordinated with the FDIC OIG Office of Management and Congressional Relations. We did not consider any pending legislation that might relate to predatory lending.

We gathered data on the federal banking regulatory agencies' policies and procedures related to predatory lending, including examination guidance and information provided to FDIC-insured financial institutions; policies and procedures for handling consumer complaints; policies and procedures related to cited violations and enforcement and/or supervisory actions; and training. We coordinated this aspect of our review through the respective federal agency Inspector General organizations.[7]

In addition, we reviewed congressional testimony related to predatory lending and reports issued by GAO, HUD and Treasury, OCC, Freddie Mac, the Center for Responsible Lending, and the FDIC on payday and subprime lending and identified a set of 21 characteristics sometimes associated with predatory, unfair, abusive, and deceptive acts or practices. Because there is no specific definition for predatory lending, we used those characteristics in reviewing DSC policies, examination procedures (safety and soundness and compliance), FILs, and Regional Directors Memoranda to develop a matrix on the extent of coverage the FDIC's guidance provides on those characteristics. Appendix III provides a list of the characteristics and their definitions.

Compliance With Laws and Regulations

We reviewed the DSC *Compliance Examination Manual* and compliance examination procedures to identify guidance for examiners on consumer protection laws that relate to predatory and subprime lending. We identified the following laws related to predatory and subprime lending.

- Equal Credit Opportunity Act,
- Fair Credit Reporting Act,
- Fair Debt Collection Practices Act,
- Fair Housing Act,
- Federal Trade Commission Act,

[7] We coordinated meetings with FRB and FTC program officials through their respective Offices of Inspector General. Our contact with HUD, OCC, and OTS was limited to meetings with their OIG officials and review of information obtained from their agency Web sites.

- Home Ownership and Equity Protection Act,
- Real Estate Settlement Procedures Act, and
- Truth in Lending Act.

Appendix II provides details on the requirements of each law. During this audit, we did not contact any state regulatory agencies to determine their efforts to identify, assess, and address predatory lending or financial institutions' compliance with state laws regarding predatory lending. We also did not determine whether the FDIC reviews its supervised financial institutions for compliance with state predatory lending laws.

DSC officials provided a sample of reports of examination (ROEs) that included instances in which DSC cited financial institutions for noncompliance with some consumer protection laws. We reviewed those ROEs solely to familiarize ourselves with how DSC addresses noncompliance with consumer protection laws. We did not review the ROEs or any applicable examination work papers to determine the extent of coverage of predatory lending characteristics during safety and soundness or compliance examinations.

In April 1975, the FDIC complied with the FTC Act in establishing a separate office to receive and respond to complaints about financial institutions that it supervises. In addition, effective July 1, 2002, the FDIC centralized its consumer affairs function with the establishment of the CRC within DSC. The CRC receives, investigates, and responds to complaints involving FDIC-supervised institutions and answers inquiries from consumers about consumer protection laws and banking practices. We did not identify any instances of FDIC noncompliance with pertinent laws and regulations.

Reliance on Computer-based Data, Government Performance and Results Act, Fraud and Illegal Acts, and Internal Control

<u>Validity and Reliability of Data from Computer-based Systems</u>

We did not use any computer-based data for evaluative purposes. Although we obtained information from DSC's automated Specialized Tracking and Reporting System (STARS) on the number and type of consumer complaints and inquiries regarding predatory lending, we did not rely on this information to achieve our audit objective. Accordingly, we did not conduct any independent testing of computer data.

<u>Performance Measures</u>

The Government Performance and Results Act of 1993 directs Executive Branch agencies to develop a strategic plan, align agency programs and activities with concrete missions and goals, manage and measure results to justify appropriations and authorizations, and design budgets that reflect strategic missions. In fulfilling its primary supervisory responsibilities, the FDIC pursues two strategic goals:

- FDIC-supervised institutions are safe and sound, and
- consumers' rights are protected, and FDIC-supervised institutions invest in their communities.

The FDIC's Strategic Plan is implemented through the Corporation's *Annual Performance Plan*. The annual plan identifies performance goals, indicators, and targets for each strategic objective. In reviewing the FDIC's *Strategic Plan* and *Annual Performance Plan*, we did not identify any strategies or performance goals directly related to predatory lending.

<u>Fraud and Illegal Acts</u>

The objective of this audit did not lend itself to testing for fraud and illegal acts. Accordingly, the survey and audit programs did not include specific audit steps to test for fraud and illegal acts. However, we were alert to situations or transactions that could have been indicative of fraud or illegal acts, and no such acts came to our attention.

<u>Internal Controls Reviewed</u>

During the audit, we gained an understanding of relevant control activities related to examinations by reviewing DSC policies and procedures as presented in *DSC's Compliance Examination Manual*, *Risk Management Manual of Examination Policies,* safety and soundness examination documentation modules, and Regional Director Memoranda.

Summary of Prior Audit Coverage

<u>GAO Audit</u>

In January 2004, GAO issued Audit Report GAO-04-280 entitled, *Federal and State Agencies Face Challenges in Combating Predatory Lending*. Chairman and Ranking Minority Member, Special Committee on Aging, U.S. Senate, requested that GAO evaluate issues related to predatory home mortgage lending. GAO's report discusses (1) federal laws related to predatory lending and federal agencies' efforts to enforce them; (2) actions taken by states to address predatory lending; (3) the secondary market's role in facilitating or inhibiting predatory lending; (4) ways in which consumer education, mortgage counseling, and loan disclosures may deter predatory lending; and (5) the relationship between predatory lending activities and elderly consumers.

FDIC OIG Audits

The FDIC OIG conducted three previous audits related to fair lending, subprime lending, and consumer protection but has not conducted any previous audits specifically related to predatory lending.

On March 26, 2002, the OIG issued Audit Report 02-009, *The Division of Compliance and Consumer Affairs' Risk-Scoping Process for Fair Lending Examinations*, on the fair lending examination risk-scoping process as conducted by the Division of Compliance and Consumer Affairs.[8] The audit focused on the FDIC's application of the *FFIEC Interagency Fair Lending Examination Procedures* and did not directly relate to the scope of our audit.

On March 18, 2003, the FDIC OIG issued Audit Report 03-019, *The Division of Supervision and Consumer Protection's Examination Assessment of Subprime Lending*, in which the OIG concluded that:

- DSC had taken reasonable steps to ensure that institutions (1) effectively manage risks associated with subprime lending programs and price loans based on risk, (2) establish adequate allowance levels to cover loan and lease losses, and (3) maintain capital levels that reflect the additional inherent risks associated with subprime lending.

- Interagency policies and procedures for examinations of subprime banks provided examiners with the necessary guidance to identify and assess the condition of subprime loan programs in insured institutions, and the examiners adequately implemented this guidance. The procedures specifically addressed the management of risk associated with subprime lending programs, stressed the need for banks' risk management programs to address loan pricing, and set forth the requirements for calculating and maintaining adequate allowances for loan and lease losses and capital levels.

- FDIC examiners conducted pre-examination planning that included steps to look for indications of subprime lending programs and generally followed the interagency subprime lending examination procedures involving examinations of capital levels during onsite examinations. In addition, DSC maintained a quarterly database to assist in monitoring the condition of FDIC-insured institutions with subprime lending programs. Further, examiners noted that institutions had implemented corrective actions as a result of DSC examination findings related to the banks' subprime lending activities, including requirements for maintaining adequate levels of capital and adequate allowances to cover loan and lease losses.

The OIG reported that existing guidance may not have been sufficient for ensuring that models used by banks to estimate the creditworthiness of credit applicants made correct predictions. As a result, there was a potential for a lack of consistency in onsite examinations of banks with subprime lending programs, particularly with regard to allowances for losses and capital-level

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[8] Effective June 30, 2002, the FDIC's Division of Supervision and Division of Compliance and Consumer Affairs merged to form the new DSC.

calculations. Also, in order for lenders to appropriately stratify the additional default risk and price the subprime products accordingly, constant monitoring and testing of credit scoring models were required to ensure that projected results were in line with actual performance. The FDIC agreed with the OIG's observations and planned to offer additional training for a select group of specialists on custom credit scoring.

On September 23, 2005, the FDIC OIG issued Audit Report 05-038 entitled, *Division of Supervision and Consumer Protection's Risk-Focused Compliance Examination Process*. The OIG concluded that DSC examiners generally complied with the policies and procedures related to risk-scoping compliance examinations and that the Risk Profile and Scoping Memorandums prepared by examiners provided an adequate basis for planned examination coverage. The examiners (1) reviewed bank policies, procedures, disclosures, and forms for compliance with consumer protection laws and regulations for each examination reviewed and (2) planned for transaction testing or spot checks in all compliance areas over the course of two consecutive examinations – a period of 2 to 6 years, depending on an institution's size and ratings. Additionally, examiners conducted transaction testing or spot checks in those areas for which apparent violations had been found at previous compliance examinations. However, the OIG found that examination documentation did not always show the transaction testing or spot checks conducted during the onsite portion of the examinations, including testing to ensure the reliability of the institutions' compliance review functions. Examiners also did not always document whether the examination reviewed all the compliance areas in the planned scope of review. As a result, DSC could not assure that the extent of testing was appropriate except for those areas in which examiners had identified violations and included them in ROEs. We recommended that DSC clarify and reinforce requirements that examiners adequately document the scope of the work performed, including transaction testing and spot checks of the reliability of the institutions' compliance review functions, during the onsite portion of compliance examinations.

DSC concurred with the recommendation and issued Regional Directors Memorandum No. 2005-035, *DSC's June 2003 Revised Compliance Examination*, which included guidance on:

- documenting changes in the scope of an examination,
- documenting spot checks of regulations,
- providing cross-checks to additional information available in *Examiner Summaries*, and
- providing descriptions of examination procedures used to conduct the examination.

We also reviewed the joint HUD and Treasury predatory lending report, *Curbing Predatory Home Mortgage Lending*, dated June 2000. The report proposed a four-point plan to address predatory lending practices—(1) improving consumer literacy and disclosures, (2) prohibiting harmful sales practices in the mortgage market, (3) restricting abusive terms and conditions on high-cost loans, and (4) improving market structure as it relates to CRA credit to banks and thrifts.

APPENDIX II

CONSUMER PROTECTION LAWS

Equal Credit Opportunity Act (ECOA) – ECOA prohibits discrimination based on race, color, religion, national origin, sex, marital status, and age in any aspect of a credit transaction. The FRB issued Regulation B, which describes lending acts and practices that are specifically prohibited, permitted, or required under ECOA.

Fair Credit Reporting Act (FCRA) – FCRA requires that consumer reporting agencies adopt reasonable procedures for meeting the needs of commerce for consumer credit, personnel, insurance, and other information in a manner that is fair and equitable to the consumer with regard to confidentiality, accuracy, relevancy, and proper utilization of information. On July 19, 2000, the FFIEC issued revised examination procedures to incorporate changes made to the FCRA as a result of the Gramm-Leach-Bliley Act (GLBA).[9]

Fair Debt Collection Practices Act (FDCPA) – FDCPA protects reputable debt collectors from unfair competition and encourages consistent state action to protect consumers from abuses in debt collection. On September 5, 1997, the FFIEC issued revised guidance to incorporate changes made to the FDCPA by the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA). EGRPRA amended the FDCPA by requiring debt collectors to inform debtors that they are attempting to collect a debt and that any information obtained could be used for that purpose.

Fair Housing Act (FHA) – The FHA prohibits discrimination based on race, color, religion, national origin, sex, familial status, and handicap in residential real-estate-related transactions, including making loans to buy, build, repair, or improve a dwelling. Lenders may not discriminate in mortgage lending based on any of the prohibited factors.

Federal Trade Commission Act (FTC Act) – The FTC Act authorizes the FTC to prohibit and take action against unfair or deceptive acts or practices in or affecting commerce. On March 11, 2004, the FDIC and FRB issued standards that will be considered by the agencies as they carry out their responsibility to enforce the prohibitions against unfair or deceptive trade practices described in the FTC Act as they apply to acts and practices of state-chartered banks.

Home Ownership and Equity Protection Act (HOEPA) – Congress enacted HOEPA in response to evidence of abusive mortgage lending, particularly lending that involves excessive interest rates and fees. HOEPA identifies a class of high-cost mortgage loans and requires that consumers who enter into these transactions be provided with additional disclosures intended to facilitate comparison with other loan products. HOEPA restricts the use of certain loan terms associated with abusive lending and authorizes FRB to issue regulations that prohibit specific types of mortgage lending practices found to be abusive. On December 20, 2001, FRB amended

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[9] In addition to reforming the financial services industry, GLBA addressed concerns relating to consumer financial privacy. Title V of the GLBA established major privacy provisions under Subtitles A and B. Subtitle A provides a mechanism to protect the confidentiality of a consumer’s nonpublic personal information. Subtitle B prohibits “pretext calling,” which is a deceptive practice used to obtain information on the financial assets of consumers. Criminal penalties and regulatory and administrative enforcement mechanisms are established to help prevent this practice.

the provisions of Regulation Z that implement HOEPA. The amendments restrict certain unfair practices and strengthen HOEPA's prohibition against extending credit without regard to a borrower's ability to repay it.

Real Estate Settlement Procedures Act (RESPA) – RESPA requires lenders, mortgage brokers, or servicers of home loans to provide borrowers with pertinent and timely disclosures regarding the nature and costs of the real estate settlement process. The Act also protects borrowers against certain abusive practices, such as kickbacks, and places limitations upon the use of escrow accounts. HUD promulgated Regulation X, which implements RESPA.

Truth in Lending Act (TILA) – TILA requires meaningful disclosure of credit and leasing terms so that consumers will be able to more readily compare terms in different credit and lease transactions. TILA also protects the consumer against inaccurate and unfair credit billing, credit card, and leasing transactions. FRB issued Regulation Z, which implements TILA. The regulation requires accurate disclosure of true cost and terms of credit. The regulation also regulates certain credit card practices, provides for fair and timely resolution of credit billing disputes, and requires that a maximum interest rate be stated in variable rate contracts secured by the consumer's dwelling.

APPENDIX III

CHARACTERISTICS POTENTIALLY ASSOCIATED WITH PREDATORY LENDING

Characteristic	Definition of Characteristic
Abusive Collection Practices	Attempting to collect debt through harassment or abuse, improper communication, false or misleading representations, or furnishing deceptive forms.
Balloon Payments	Loans with balloon payments are structured so that monthly payments are lower, but one large payment (the balloon payment) is due when the loan matures. Predatory loans may contain a balloon payment with unrealistic repayment terms, which the borrower is unlikely to be able to afford, resulting in foreclosure or refinancing with additional high costs and fees. Sometimes, lenders market a low monthly payment without adequate disclosure of the balloon payment. Balloon payments disguise the true, higher-than-expected cost of the loan.
Encouragement of Default	Encouraging a borrower to breach a contract and default on an existing loan prior to and in connection with the consummation of a loan that refinances all or part of the existing loan.
Equity Stripping	Repeat financings where the equity is depleted as a result of financing excessive fees.
Excessive Fees	Abusive loans may include fees that greatly exceed the amounts justified by the costs of the services provided and the credit and interest rate risks involved. Lenders may add these fees to the loan amounts rather than requiring payment up front, so the borrowers may not know the exact amount of the fees they are paying.
Excessive Interest Rates	Mortgage interest rates can legitimately vary based on the characteristics of borrowers (such as creditworthiness) and of the loans themselves. However, in some cases, lenders may charge interest rates that far exceed what would be justified by any risk-based pricing calculation, or lenders may "steer" a borrower with an excellent credit record to a higher-rate loan intended for borrowers with poor credit histories.
Fraud, Deception, and Abuse	Predatory lenders may perpetrate outright fraud through actions such as inflating property appraisals and doctoring loan applications and settlement documents. Unscrupulous lenders often prey on certain groups—the elderly, minorities, and individuals with lower incomes and less education, with deceptive or high-pressure sales tactics.
High Loan-to-Value Ratio	These loans effectively prohibit homeowners from selling their homes or filing bankruptcy to escape unaffordable debt, without losing their home.
Lending Without Regard to Ability to Repay	Loans may be made without regard to a borrower's ability to repay the loan. In these cases, the loans are approved based on the value of the asset (the home) that is used as collateral. In particularly egregious cases, monthly loan payments have equaled or exceeded the borrower's total monthly income. Such lending can quickly lead to foreclosure of the property.
Loan Flipping	Mortgage originators may refinance borrowers' loans repeatedly in a short period of time without any economic gain for the borrower. With each successive refinancing, these originators charge high fees that are folded into the loan balance and "strip" borrowers' equity in their homes.
Mandatory Arbitration Clauses	Mandatory arbitration clauses limit homeowners' choices for dispute resolution, thereby preventing victims of predatory lending practices from suing for damages.

APPENDIX III

Characteristic	Definition of Characteristic
Payday Lending	Payday loans are small-dollar, unsecured, short-term advances that have high fees relative to the size of the loan. When used frequently or for long periods, the total costs can rapidly exceed the amount borrowed.
Pre-payment Penalties	Penalties for prepaying a loan are not necessarily abusive, but predatory lenders may use them to trap borrowers in high-cost loans.
Refinancing of Special Mortgages	Special subsidized mortgages that contain terms favorable to the borrower are refinanced with a loan that does not provide a tangible economic benefit to the borrower relative to the refinanced loan.
Refinancing Unsecured Debt	The process of using an individual's home as collateral to refinance unsecured debt such as credit cards or medical debts. This process can be disadvantageous because creditors of unsecured debt can rarely take a borrower's property for nonpayment. However, creditors who refinance unsecured debt using a home as collateral can take the home for nonpayment.
Repetitive Refinancing	Repeatedly refinancing a loan within a short period of time and charging high points and fees with each refinancing. The repeated refinancing has the effect of stripping the homeowner's equity from the home by increasing the amount borrowed in each refinancing without providing any benefit to the borrower.
Single-Premium Credit Insurance	Credit insurance is a loan product that repays the lender should the borrower die or become disabled. In the case of single-premium credit insurance, the borrower pays the total premium upfront rather than on a monthly basis because it is added to the amount financed in the loan. The process of adding the full premium to the amount of the loan unnecessarily raises the amount of interest borrowers pay. Therefore, single-premium credit insurance is generally considered inherently abusive.
Spurious Open-End Loans	The lender is allowed to avoid the more comprehensive disclosures required by closed-end credit and thereby avoid any chance of the homeowner asserting the right of rescission, avoiding the restrictions under the HOEPA, regardless of the cost of the loan.
Steering	The process of referring borrowers who qualify for lower-cost financing to high-cost lenders. Subprime lenders will charge prime borrowers who meet conventional underwriting standards higher rates than necessary.
Subprime Lending	Subprime borrowers typically have weakened credit histories that include payment delinquencies and possibly more severe problems such as charge-offs, judgments, and bankruptcies. Such borrowers may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. Generally, predatory mortgage lending occurs in the subprime market.
Yield-Spread Premiums	The payment a mortgage broker receives from a lender based on the difference between the actual interest rate on the loan and the rate the lender would have accepted on the loan given the risks and costs involved. The higher the actual loan rate compared with the acceptable loan rate, the higher the yield-spread premium. Yield-spread premiums provide incentives for mortgage brokers to steer borrowers into higher-cost loans.

Source: OIG review of congressional testimony related to predatory lending and reports issued by GAO, HUD and Treasury, OCC, Freddie Mac, the Center for Responsible Lending, National Consumer Law Center, and the FDIC on payday and subprime lending.

INFORMATION PROVIDED BY OTHER FEDERAL REGULATORY AGENCIES

This appendix contains chronological information related to actions taken by OTS and OCC to address predatory lending. The appendix includes (1) information discussed in detail in our report in the section entitled, *Issues for Consideration*, and (2) supplemental information provided by OCC and OTS that was not included in our review of the agencies' efforts to address predatory lending and, therefore, was not verified during the audit. (The supplemental information is excerpted and shown in italics below.)

<u>OTS</u>

OTS has issued examination-scoping guidance and a *Strategic Plan* that specifically addresses predatory lending. The OTS Examination Scope Worksheet, which examiners use to determine whether a specific issue should be included in the examination scope, includes a line item for an assessment of predatory lending issues. Further, the OTS *Strategic Plan* includes a performance goal to maintain a thrift industry that effectively complies with consumer protection laws. As stated in the plan, one of the strategies OTS uses for achieving performance is to "conduct examinations with a top-down, risk focused approach that promotes comprehensive compliance management including the establishment of adequate internal controls to ensure regulatory compliance and to avoid predatory practices."

> *OTS received numerous comments from financial institutions and other interested parties when OTS issued an ANPR [Advance Notice of Proposed Rulemaking] on "Responsible Alternative Mortgage Lending" in April 2000. (65 Fed. Reg. 17811 (April 5, 2000)). OTS's rule, created during a high interest rate environment when many state laws prohibited ARMS, granted state-chartered thrifts and non-depository institutions preemption under the Alternative Mortgage Transaction Parity Act from state laws on alternative mortgages. Over the years, this preemption frustrated the states from enforcing consumer protections relating to prepayment penalties and late charges. OTS addressed the issue in September 2002 in its final rulemaking on the Alternative Mortgage Transaction Parity Act (AMTPA).*
>
> *In addition, OTS has taken a number of affirmative steps to stop or prevent institutions from offering loans with predatory characteristics. These actions include directing institutions (and requiring them through normal and formal enforcement actions) to close certain types of lending programs and directing certain institutions to divest their thrift charters. OTS also makes referrals concerning possible Equal Credit Opportunity Act violations by mortgage brokers and others to the Federal Trade Commission and Department of Justice, and discrimination complaints to Department of Justice and the Department of Housing and Urban Development.*

In addition to the interagency guidance noted previously, OTS has issued guidance on title loan programs and payday lending[10] in CEO [Chief Executive Officer] Letters 131 and 132. This guidance states that OTS will closely review the activities of savings associations engaged in title loan programs and payday lending to ensure that they are following prudent, non-abusive lending practices.

OCC

The OCC conducts risk-based consumer compliance reviews that require examiners to determine the quantity of risk inherent in the bank's products and services associated with consumer protection laws and regulations, including those addressing predatory lending and unfair or deceptive acts or practices. Consumer complaint data are reviewed and analyzed for early warning indicators of potential unfair, deceptive, abusive, and predatory practices. Examiners also evaluate the adequacy of the financial institution's risk management practices used to identify, measure, monitor, and control the institution's compliance and reputation risk. If the quantity of risk is high and exposes the institution to significant risk or the compliance management system is inadequate to address the quantity of risk identified, examiners may expand their review to ensure the institution is in compliance with applicable laws and regulations.

In December 2004, OCC issued revised risk-based Retail Lending Examination Procedures. Minimum examination procedures are used in all banks, and they may indicate the need for more extensive review of all or parts of a bank's retail lending activities. As part of the minimum examination procedures, examiners determine whether the bank's lending activities include indicators of predatory lending, such as whether underwriting policies provide appropriate guidance on assessing that the borrower's capacity to repay the loan is based on a consideration of the borrower's income, financial resources, and debt service obligations, and whether the bank's policies and procedures provide adequate guidance to avoid discriminatory, unfair, deceptive, predatory, and abusive lending practices. If examiners determine that supplemental examination procedures are necessary, those procedures include assessments that identify predatory lending practices.

- *In July 2000, the OCC issued an advisory letter addressing abusive lending practices. The advisory letter identified a number of practices that may indicate that an institution may be engaging in abusive lending and violations of fair lending statutes and other consumer protection provisions.*

- *In November 2000, the OCC issued an advisory letter alerting national banks to concerns raised by title lending arrangements with third parties. Such arrangements raise significant consumer protection concerns, because of the high cost of the loan, and may involve abusive lending and collection practices.*

[10] A title loan is a short-term consumer loan made to an individual secured by clear title to the borrower's vehicle. Payday loans are small-dollar, short-term loans that borrowers promise to repay out of their next paycheck.

- *Also in November 2000, the OCC issued an advisory letter to ensure that any national bank that engages in payday lending does so in a safe and sound manner and does not engage in abusive practices that would increase the compliance, legal, and reputational risks associated with payday lending and could harm the bank's customers.*

- *In March 2002, the OCC issued an advisory to inform national banks and their operating subsidiaries about the risks present in engaging in lending and marketing practices that may constitute unfair or deceptive acts or practices, and to help national banks to avoid being placed in jeopardy of penalties, judgments, and harm to their reputations that can result from such practices.*

- In February 2003, OCC issued two advisory letters related to predatory lending to the national banks and operating subsidiaries it supervises, as discussed earlier in this report.

- In January 2004, OCC issued a rule adopting anti-predatory lending standards that expressly prohibit national banks from making consumer and mortgage loans based predominantly on the foreclosure value of the borrower's collateral and engaging in unfair and deceptive practices, as discussed earlier in this report.

- *In April 2004, the OCC issued an advisory letter intended to help national banks identify risks that are presented by secured credit cards and to provide guidance on how to address such risks, so that national banks that elect to offer secured credit cards do so in a safe and sound manner that treats customers fairly and promotes responsible credit access.*

- In September 2004, OCC issued an advisory letter alerting national banks regarding OCC's concerns about certain credit card marketing and account management practices, as discussed earlier in this report.

- In February 2005, OCC issued guidelines for national bank residential mortgage lending standards to further the OCC's goal of ensuring that national banks do not become involved in predatory, abusive, unfair, or deceptive residential mortgage lending practices, as discussed earlier in this report.

The OCC has used its 12 U.S.C. [United States Code] *§ 1818 enforcement authority to bring actions against national banks that have engaged in unfair or deceptive acts or practices. These enforcement actions include two predatory mortgage lending cases and several cases involving credit card issuers that engaged in unfair or deceptive acts or practices. The enforcement actions have resulted in over $300 million in relief for consumers.*

CORPORATION COMMENTS

FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990 Division of Supervision and Consumer Protection

DATE: June 1, 2006

TO: Stephen M. Beard
Deputy Assistant Inspector General for Audits

FROM: Sandra L. Thompson [Electronically produced version; original signed by Sandra L. Thompson]
Acting Director

CONCUR: John F. Bovenzi [Electronically produced version; original signed by John F. Bovenzi]
Deputy to the Chairman and Chief Operating Officer

SUBJECT: Draft Report Entitled *Challenges and FDIC Efforts Related to Predatory Lending* (Assignment No. 2005-023)

This memorandum represents the Division of Supervision and Consumer Protection (DSC) response to the draft report entitled, *Challenges and FDIC Efforts Related to Predatory Lending*. (Assignment No.2005-023) ("Draft Report") prepared by the FDIC's Office of Inspector General (OIG). The objective of the OIG audit, started on March 2, 2005, was to determine challenges faced and efforts undertaken by the FDIC to identify, assess, and address the risks posed to institutions and consumers by predatory lending. The OIG also reviewed the efforts taken by the other federal banking regulators to address predatory lending.

The Draft Report recognizes the significant supervisory challenges attendant to predatory lending and identifies certain characteristics that are potentially indicative of predatory lending activities. The Draft Report recommends that the FDIC 1) clarify its overall approach to predatory lending, and 2) review existing guidance to identify gaps in examiner coverage of predatory lending. DSC agrees with these recommendations and will develop an overall supervisory approach to predatory lending that will include a review of existing supervisory policies and practices. DSC will also review existing examiner guidance and, if necessary, develop additional guidance to address predatory lending. These actions will be completed by year-end.

Overview

The FDIC ensures that the 5,000 banks under its supervision engage in safe and sound lending, adhere to consumer protection laws, and invest in their communities. Predatory lending often involves both borrower deception and poor underwriting standards. The FDIC thus views predatory lending as a major consumer protection challenge and a significant safety and soundness concern. FDIC efforts to address predatory lending have been in place formally since 1999 and include: examiner guidance in both the risk management and compliance disciplines; enforcement policy; public policy advancement through speeches and testimony; and active financial education and other outreach activities.

APPENDIX V

Examination Guidance and Training

Predatory lending is most often associated with abusive lending practices in the subprime mortgage market. In 2001, the banking agencies jointly issued *Expanded Examination Guidance for Subprime Lending Programs*. The expanded guidance, which supplements previous subprime lending examination guidance issued in 1999, was developed to strengthen the examination and supervision of institutions with significant subprime lending programs. Moreover, this expanded examination guidance formed the basis of an interagency predatory lending examination strategy for risk management and compliance examinations. The FDIC took a leadership role to ensure the examination guidance distinguished between well-managed and responsible .subprime lending programs and subprime lending programs that involved predatory practices. The examination guidance provides a useful overview of the issue of predatory lending in the subprime mortgage market and reflects the approach of the agencies to the issue. It states, in part:

> The term subprime is often misused to refer to certain "predatory" or "abusive" lending practices. The Agencies have previously expressed their support for lending practices designed to responsibly service customers and enhance credit access for borrowers with special credit needs. Subprime lending that is appropriately underwritten, priced, and administered can serve these goals. However, the Agencies also recognize that some forms of subprime lending may be abusive or predatory. Some such lending practices appear to have been designed to transfer wealth from the borrower to the lender/loan originator without a commensurate exchange of value. This is sometimes accomplished when the lender structures a loan to a borrower who has little or no ability to repay the loan from sources other than the collateral pledged. When default occurs, the lender forecloses or otherwise takes possession of the borrower's property (generally the borrower's home or automobile). In other cases, the lender may use the threat of foreclosure/repossession to pressure the borrower for payment. Typically, predatory lending involves at least one, and perhaps all three, of the following elements:
>
> - Making unaffordable loans based on the assets of the borrower rather than on the borrower's ability to repay an obligation;
> - Inducing a borrower to refinance a loan repeatedly in order to charge high points and fees each time the loan is refinanced ("loan flipping"); or
> - Engaging in fraud or deception to conceal the true nature of the loan obligation, or ancillary products, from an unsuspecting or unsophisticated borrower.
>
> Loans to borrowers who do not demonstrate the capacity to repay the loan, as structured, from sources other than the collateral pledged are generally considered unsafe and unsound. <u>Such lending practices should be criticized in the Report of Examination as imprudent. Further, examiners should refer any loans with the aforementioned characteristics to their Agency's respective consumer compliance/fair lending specialists for additional review.</u>

In addition to the 2001 guidance, the FDIC has issued guidance on matters related to predatory lending, whether or not labeled as such.[1] In 2004, to make certain that the industry understood our concerns, the FDIC and Federal Reserve Board jointly issued detailed guidance about how to avoid unfair or deceptive practices. And, in June 2005, the FDIC issued examination procedures intended to ensure that FDIC examiners have the tools necessary to evaluate compliance with the FTC Act.

The FDIC has also recently worked closely with the other financial regulatory agencies to develop guidance for banks about non-traditional mortgage products. As the Draft Report recognizes, these products pose a supervisory challenge because they, "...may contain terms that are appropriate for some borrowers but predatory to others".[2] The proposed guidance addresses both safety and soundness and consumer protection concerns.

Both compliance and risk management examiners at the FDIC have received training in the last several years on issues and activities associated with predatory lending. The training highlighted issues raised by consumer organizations, findings by several government studies, and unfair and deceptive practices found by the federal banking agencies. As a result of this training, examiners have a heightened awareness of predatory lending concerns and are prepared to address them by applying both consumer protection laws and safety and soundness standards. Additionally, in 2002, the FDIC established a Fair Lending Examination Specialist Program that assigned an expert Fair Lending Examination Specialist to each Regional and Area Office to assist compliance examiners in conducting fair lending examinations. These examinations include consideration of discriminatory lending and certain predatory lending activities, such as discriminatory pricing and steering.

Enforcement Policy

The FDIC has vigorously enforced existing consumer protection and fair lending laws and regulations, including the Home Ownership and Equity Protection Act of 1994, the Truth in Lending Act, the Real Estate Settlement Procedures Act, the Fair Housing Act, the Equal Credit Opportunity Act, the Community Reinvestment Act, and the Federal Trade Commission Act (FTC Act). These authorities provide the FDIC with a range of tools to address predatory lending practices.

The Draft Report states there is no universally accepted definition of predatory lending.[3] In a report issued in June 2000, HUD and the Treasury Department explained that "... the predatory nature of many loans typically is not the result of a single term or characteristic, but a

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1 See, e.g., Interagency *Guidelines for Subprime Lending,* published by the FDIC through FIL -20-99, and Interagency *Expanded Guidance for Subprime Lending Programs*, published by the FDIC through Financial Institution Letter (FIL) 9-2001.

2 Draft Report at p. 3.

3 Draft Report at p.1.

series of characteristics that in combination impose substantial hardship on the borrower". [4] We agree with the Draft Report that identifying or recognizing predatory lending in a specific loan transaction can be a challenge because each loan transaction must be viewed in its totality, including the associated marketing practices, terms of the agreement, various parties involved in the loan transaction, and financial sophistication of the parties involved. As a result, there is no simple "checklist" to follow in identifying predatory lending.[5]

In view of this challenge, we agree with the Draft Report that Section 5 of the FTC Act is an important tool to use where otherwise lawful loan features are included in transactions in an unfair and deceptive way. These features include balloon payments, high loan to value loans, prepayment penalties, mandatory arbitration clauses, high cost ancillary products such as single-premium life insurance, and high cost fees financed into the loan. While subprime lending is a legal activity, some consumers accept subprime products because they have been misled about whether they qualify for products with prime rates and terms or about the features of the subprime loans. As the Draft Report states:

> [T]he FDIC can rely on the FTC Act as authority for issuing enforcement actions against financial institutions for unfair, abusive, and deceptive acts or practices, which could include <u>any or all</u> of the characteristics potentially associated with predatory lending that our [OIG] research identified during this audit.[6]

Although the FDIC to date has not identified violations involving unfair or deceptive practices in mortgage lending by FDIC supervised institutions, we have taken enforcement action against institutions that violated the FTC Act in a different context involving other credit products. OIG staff reviewed compliance examination reports that documented our action.[7] The FDIC is prepared to extend enforcement of the FTC Act to mortgage lending.

Public Policy: Speeches & Testimony

The FDIC has also made its concerns about predatory lending known in numerous speeches and testimony by FDIC officials since 2000. These include speeches before forums sponsored by the National Association of Affordable Lenders, the National Congress for Community and Economic Development, America's Community Bankers and others, and testimony before Congress. These public statements of policy addressed the different types of predatory practices discussed in the Draft Report, in addition to others, and laid out strategies to identify and prevent predatory lending. The collected speeches and testimony provided guidance not only to the industry, but also communicated the FDIC perspective on predatory lending to examiners as well.

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4 <u>See</u> "The National Predatory Lending Task Force, Curbing Predatory Home Mortgage Lending: A Joint Report, U.S. Department of Housing and Urban Development and U.S. Department of Treasury" (June 2000). (HUD/Treasury Report).

5 Draft Report at p. 3.

6 Draft Report at p. 11 (emphasis added).

7 <u>Id</u>. at p.21.

APPENDIX V

Financial Education

In addition to our supervisory programs, the FDIC's ongoing public awareness and education initiatives play an important part in combating predatory practices and complement our supervisory programs. As acknowledged in the Draft Report, the FDIC has long recognized the value of consumer education as an additional tool in combating predatory lending abuses. The FDIC's award-winning *Money Smart* financial education program and the *FDIC Consumer News* play an important role in the FDIC's efforts to provide helpful free information to the public, financial institutions and our examination staff.

The FDIC's financial education program is primarily focused on helping low- and moderate-income adults develop money-management skills. Two versions are available for free– one for classroom use (in English, Spanish, Chinese, Korean, Vietnamese, and Russian), the other for computer-based, self-paced learning (in English and Spanish). Classes are offered through an extensive network of *Money Smart* "partners," including financial institutions, non-profit organizations and government agencies. Since 2001, about 495,000 people have taken *Money Smart* classes and 95,000 new banking relationships have been established.

In addition, FDIC Community Affairs staff have hosted or participated in numerous anti-predatory lending conferences and forums that promote the use of *Money Smart* and other means to prevent predatory lending or correct its effects on low and moderate-income individuals and others.

Conclusion

In summary, predatory lending harms individuals and communities and raises risk management and consumer compliance concerns for financial institutions. Predatory loans can have a negative impact on a bank's Community Reinvestment Act evaluation. The loans may violate fair lending laws and other consumer protection laws, resulting in legal or regulatory action. Questionable loan underwriting and the risk of litigation raise additional safety and soundness concerns. For these reasons, the FDIC maintains a strong supervisory strategy developed over several years to combat predatory lending in the financial system through vigorous safety and soundness and compliance examination and enforcement, industry outreach and adult financial education programs. The development of an articulated overall supervisory approach to predatory lending, based on a review of existing supervisory polices and practices that address predatory lending, as recommended by the OIG Draft Report, will enhance the FDIC's efforts in this area. We will complete this task by year-end.

APPENDIX V

OIG Recommendation

"Describe in policy the FDIC's overall supervisory approach to predatory lending."

DSC Response

The FDIC agrees that it will be beneficial to articulate an overall supervisory approach as stated above to address any predatory lending practices that FDIC examiners may find. By year-end, DSC will develop a formal policy statement describing its approach to combating predatory lending.

OIG Recommendation

"Review existing examiner, financial institution, and consumer guidance and determine whether additional guidance is needed to address predatory lending."

DSC Response

The Draft Report suggests that we consider the approaches of the other agencies. The supervisory approaches of the OCC and OTS to predatory lending are based, in large part, on their authority under the National Bank Act and Home Owners Loan Act to supervise institutions pursuant to federal law. The FDIC has worked closely with state supervisors to take action to address activities that violate state anti-predatory lending laws. As explained above, the FDIC has also required banks subject to its supervision to correct unfair and deceptive acts or practices under the FTC Act and disengage from unsafe or unsound lending practices.

The Federal Reserve Board, which also works with state authorities, mentions predatory lending as a potential risk to be considered when evaluating reputation risk during examinations. FDIC examiners undertake a similar risk assessment, although the guidance does not use the phrase "predatory lending." Under the FTC Act examination guidance issued in June 2005, FDIC compliance examiners must consider the risks for unfair or deceptive acts or practices when they develop a risk profile for an institution. To assess this risk, examiners evaluate: consumer complaints received by the bank or the FDIC; whether the bank's product lines are high risk; the quality of the bank's compliance management system; and the bank's past performance.

We will carefully review any overall supervisory strategy in use by the other agencies with an eye to enhancing the FDIC's strategy as the OIG suggests. By year-end, DSC will complete the recommended review and determine whether any new or enhanced policy or guidance is necessary in light of the strategy statement developed in response to Recommendation 1.

MANAGEMENT RESPONSE TO RECOMMENDATIONS

This table presents the management response on the recommendations in our report and the status of the recommendations as of the date of report issuance.

Rec. Number	Corrective Action: Taken or Planned/Status	Expected Completion Date	Monetary Benefits	Resolved:[a] Yes or No	Open or Closed[b]
1	DSC will develop an overall supervisory approach to predatory lending that will include a review of existing supervisory policies and practices.	December 31, 2006	NA	Yes	Open
2	DSC will review existing predatory lending guidance and, if necessary, develop additional guidance to address predatory lending.	December 31, 2006	NA	Yes	Open

[a] Resolved – (1) Management concurs with the recommendation, and the planned corrective action is consistent with the recommendation.
(2) Management does not concur with the recommendation, but planned alternative action is acceptable to the OIG.
(3) Management agrees to the OIG monetary benefits, or a different amount, or no ($0) amount. Monetary benefits are considered resolved as long as management provides an amount.

[b] Once the OIG determines that the agreed-upon corrective actions have been completed and are effective, the recommendation can be closed.

Exhibit G

ADVANCE AMERICA

CUSTOMER AGREEMENT

DATE ISSUED 08/08/2013 15:24:05

LOAN ID# 108403

CUSTOMER COMMENT LINE: 1-800-916-6519

ENDER:
CAS of Delaware, LLC
/b/a Advance America, Cash Advance Centers; Advance America
720 Philadelphia Pike
laymont, Delaware 19703
hone: (302)792-1254 Fax: (302)792-1546

BORROWER:
Edmund Ziegler
[redacted]
Wilmington, Delaware 19805
Phone: [redacted]
Customer # 179062

he Parties. This agreement is between Edmund Ziegler ("you", "your") and NCAS of Delaware, LLC ("Advance America", we", "us").

'our Loan. We agree to loan you $650.00. For that loan, we will charge you simple interest at the rate of 389% annually on npaid principal balances, computed on the actual days elapsed, and based upon a 365-day year. You agree to repay your oan according to the payment schedule shown below. All payments made under this agreement must be in cash or by ACH ebit, money order or cashier's check. The "ACH Authorization" section below gives us permission to electronically debit your ank account on each scheduled due date for the unpaid amount of the payment due. We will apply your payments first to ccrued and unpaid interest and then to principal.

'ederal Truth-In-Lending Act Disclosures.

ANNUAL PERCENTAGE RATE The cost of your credit as a yearly rate.	**FINANCE CHARGE** The dollar amount the credit will cost you.	Amount Financed The amount of credit provided to you or on your behalf.	Total of Payments The amount you will have paid after you have made all payments as scheduled.
387.16%	$846.94	$650.00	$1496.94

Payment Schedule.

Number of Payments	Amount of Payments	When Payments Are Due
1	$249.50	09/03/2013
2	$249.50	10/03/2013
3	$249.50	11/03/2013
4	$249.50	12/03/2013
5	$249.50	01/03/2014
6	$249.44	02/03/2014

Security. The ACH Authorization you have provided is security for this loan.

Prepayment. If you pay off early, you will not have to pay a penalty, and you may be entitled to a rebate of the finance charge.

See the terms below and on Page 2 of this agreement for additional information about nonpayment, default, and lack of prepayment penalties.

Itemization of Amount Financed: Amount given to you directly: $ 650.00.

Right to Cancel. You may cancel this loan and avoid paying any interest by returning either the loan proceeds check we gave you or the loan amount in cash, money order, or cashier's check before our office closes on **08/10/2013.**

Prepayment. You may make a partial payment or pay off your loan in full at any time without any additional charge or penalty.

Default. You will be in default under this agreement if we have not received the full amount of any scheduled payment by the close of regular business hours on the **10th day** after it is due. You have the right to cure your first two (2) defaults under this agreement. The first two (2) times you default, we will provide you with a notice of default, and you will have twenty (20) days to cure the default by paying the total amount of due and unpaid principal and interest. If you do not cure the default within twenty (20) days, or if you default a third time, your loan will become immediately due and payable without any further notice or demand from us. The ACH Authorization below explains how we may debit your bank account to collect the unpaid balance of your loan following default.

ACH AUTHORIZATION. You are giving us permission to initiate electronic debits to your bank account number 4276353095 at Commerce Bank, Na with routing number 031201360: (1) for the unpaid amount of each regularly scheduled payment (not to exceed $ 249.5) on each payment due date; and (2) for the full amount of outstanding principal and interest on your loan at any time after you default under this agreement and any applicable notice and cure period has passed. The "Default" section above explains default and your right to cure. You understand and acknowledge that you are receiving a reduced interest rate in exchange for giving us permission to debit your account as provided in this ACH Authorization and that you are not required to give us this permission in order to obtain a loan from us. You authorize us to verify all of the information that you have provided about your bank account, including the name of your bank, your bank routing and transit number, and your account number. If any of the information you provided is incorrect or incomplete, you authorize us to verify and correct that information. You acknowledge and agree that our authority to initiate ACH debits to your bank account ends when the earlier of the following occurs: (1) the outstanding balance on your loan is reduced to zero or (2) you revoke your authorization by presenting us with a signed ACH Revocation Form in such time as to give us and your bank a reasonable opportunity to act on it. If any ACH debit we initiate under this ACH Authorization is returned unpaid for insufficient funds, we may re-present the debit a maximum of two (2) additional times within 180 days of the first entry. The "Returned Debit Fee" section below describes the fees you may be charged for a returned ACH debit.

Initial: EZ

eturned Debit Fee. If any ACH debit that we initiate under this ACH Authorization is returned unpaid for insufficient funds, e may charge you a one-time fee of $15. We will only charge you one such fee during the life of your loan, even if you have ore than one returned ACH debit, but your bank may charge you an additional fee each time a debit is returned unpaid.

riminal Prosecution. You cannot be arrested or charged with a crime for failure to repay this loan.

ays to Contact You. Subject to applicable law, we may contact you about our services as well as your loan by any of the llowing means: text messaging, email, and calls to your home, work, or cell phones.

ssignment. Subject to applicable law, we may sell or transfer this agreement or any of our rights under this agreement to ny party, including a collection agency.

overning Law. This agreement will be governed by the laws of the State of Delaware, except the section on Dispute esolution, which is governed by the Federal Arbitration Act.

everability Clause. If any provision of this agreement is held unenforceable, such provision will be unenforceable, and the emainder of this agreement will remain operative and binding on you and us.

DISPUTE RESOLUTION

If you have any dispute with us or if we have any dispute with you, then both you and we must seek resolution of the dispute in either small claims court or in arbitration. If your dispute cannot be filed in small claims court for any reason, then you must seek resolution of your dispute in arbitration. Regardless of the forum, you may not pursue the resolution of any dispute in a representative, private attorney general, or class action, and you may not be a named or unnamed class member in any such action. If you seek resolution of your dispute in arbitration, we will pay the arbitrator's fees and any other reasonable expenses attributable to the arbitration. In addition, if you recover an award of monetary and/or equitable relief that is greater than any we previously offered to settle your dispute, then we will pay your reasonable attorney fees. Regardless of the result of the arbitration, we will not be entitled to recover any fees or arbitration expenses from you. The arbitration hearing will be held at a location of your choice within your home state with a nationally recognized provider of arbitration services. The rules of the arbitration provider will apply, except that the parties may engage in such discovery as would be permitted by the Federal Rules of Civil Procedure. This dispute resolution agreement does not alter any substantive rights that you may have under State or Federal law, including, without limitation, any right you may have to be awarded statutory or punitive damages. This dispute resolution agreement is your and our exclusive procedure for resolving any dispute. You may unilaterally opt out of this dispute resolution agreement by following the procedure outlined below. We may not opt out unless you first opt out.

DISPUTE RESOLUTION OPT-OUT

You may opt out of the above dispute resolution agreement by sending a letter to NCAS of Delaware, LLC, Attn: Arbitration Opt Out, P.O. Box 3058, Spartanburg, SC 29304-3058, within 30 days after signing this agreement. Your opt-out only applies to the above agreement. You may opt out of the dispute resolution agreement each time you borrow from us but you must send a separate opt out letter for each agreement. Please include your name, address, social security number, and the date of this agreement in your letter.

3y signing this agreement, you agree and confirm:

- you have read, understand, and agree to all of its terms;
- the agreement was completed before you signed it;
- all information you provided to obtain this loan is accurate;
- you are not currently involved in or planning to file bankruptcy proceedings;
- this agreement contains all of the terms agreed to between you and us regarding your loan;
- you were not required to provide an ACH Authorization to receive this loan;
- you may revoke your ACH authorization as described in the "ACH Authorization" section of this agreement; and
- you have not relied on us to act in your interest as to this transaction.

Borrower's Signature: ____________________ Date: 08/08/2013

NCAS of Delaware, LLC

By: ____________________ Date: 08/08/2013

Comments or questions may be directed to our Comment Line at the following toll-free number: 1-800-916-6519.

VERIFICATION

I, Edmund Zieger, hereby verify that the foregoing *Verified Complaint* and the facts regarding me recited therein are true and correct to the best of my knowledge, information and belief. This verification is made under penalties of perjury.

By: Edmund Zieger

STATE OF Delaware)
)
COUNTY OF New Castle)

SWORN TO AND SUBSCRIBED before me this 27 day of August 2013.

Notary Public
My Commission Expires:

RICHARD H. CROSS
ATTORNEY AT LAW
1997
DELAWARE
NOTARIAL OFFICER

JS 44 (Rev. 12/12)

CIVIL COVER SHEET

The JS 44 civil cover sheet and the information contained herein neither replace nor supplement the filing and service of pleadings or other papers as required by law, except as provided by local rules of court. This form, approved by the Judicial Conference of the United States in September 1974, is required for the use of the Clerk of Court for the purpose of initiating the civil docket sheet. *(SEE INSTRUCTIONS ON NEXT PAGE OF THIS FORM.)*

I. (a) PLAINTIFFS
EDMUND ZIEGER,

(b) County of Residence of First Listed Plaintiff New Castle
(EXCEPT IN U.S. PLAINTIFF CASES)

(c) Attorneys *(Firm Name, Address, and Telephone Number)*
Richard H. Cross, Jr., Cross & Simon, LLC
913 N. Market Street, 11th Floor, Wilmington, DE 19801
(302) 777-4200

DEFENDANTS
ADVANCE AMERICA, CASH, ADVANCE CENTERS, INC. d/b/a ADVANCE AMERICA, NCAS OF DELAWARE, LLC d/b/a ADVANCE AMERICA,

County of Residence of First Listed Defendant
(IN U.S. PLAINTIFF CASES ONLY)
NOTE: IN LAND CONDEMNATION CASES, USE THE LOCATION OF THE TRACT OF LAND INVOLVED.

Attorneys *(If Known)*

II. BASIS OF JURISDICTION *(Place an "X" in One Box Only)*

- ☐ 1 U.S. Government Plaintiff
- ☐ 3 Federal Question *(U.S. Government Not a Party)*
- ☐ 2 U.S. Government Defendant
- ☒ 4 Diversity *(Indicate Citizenship of Parties in Item III)*

III. CITIZENSHIP OF PRINCIPAL PARTIES *(Place an "X" in One Box for Plaintiff and One Box for Defendant)*
(For Diversity Cases Only)

	PTF	DEF		PTF	DEF
Citizen of This State	☐ 1	☐ 1	Incorporated *or* Principal Place of Business In This State	☐ 4	☒ 4
Citizen of Another State	☒ 2	☐ 2	Incorporated *and* Principal Place of Business In Another State	☐ 5	☐ 5
Citizen or Subject of a Foreign Country	☐ 3	☐ 3	Foreign Nation	☐ 6	☐ 6

IV. NATURE OF SUIT *(Place an "X" in One Box Only)*

CONTRACT
- ☐ 110 Insurance
- ☐ 120 Marine
- ☐ 130 Miller Act
- ☐ 140 Negotiable Instrument
- ☐ 150 Recovery of Overpayment & Enforcement of Judgment
- ☐ 151 Medicare Act
- ☐ 152 Recovery of Defaulted Student Loans (Excludes Veterans)
- ☐ 153 Recovery of Overpayment of Veteran's Benefits
- ☐ 160 Stockholders' Suits
- ☒ 190 Other Contract
- ☐ 195 Contract Product Liability
- ☐ 196 Franchise

REAL PROPERTY
- ☐ 210 Land Condemnation
- ☐ 220 Foreclosure
- ☐ 230 Rent Lease & Ejectment
- ☐ 240 Torts to Land
- ☐ 245 Tort Product Liability
- ☐ 290 All Other Real Property

TORTS

PERSONAL INJURY
- ☐ 310 Airplane
- ☐ 315 Airplane Product Liability
- ☐ 320 Assault, Libel & Slander
- ☐ 330 Federal Employers' Liability
- ☐ 340 Marine
- ☐ 345 Marine Product Liability
- ☐ 350 Motor Vehicle
- ☐ 355 Motor Vehicle Product Liability
- ☐ 360 Other Personal Injury
- ☐ 362 Personal Injury - Medical Malpractice

PERSONAL INJURY
- ☐ 365 Personal Injury - Product Liability
- ☐ 367 Health Care/ Pharmaceutical Personal Injury Product Liability
- ☐ 368 Asbestos Personal Injury Product Liability

PERSONAL PROPERTY
- ☐ 370 Other Fraud
- ☐ 371 Truth in Lending
- ☐ 380 Other Personal Property Damage
- ☐ 385 Property Damage Product Liability

CIVIL RIGHTS
- ☐ 440 Other Civil Rights
- ☐ 441 Voting
- ☐ 442 Employment
- ☐ 443 Housing/ Accommodations
- ☐ 445 Amer. w/Disabilities - Employment
- ☐ 446 Amer. w/Disabilities - Other
- ☐ 448 Education

PRISONER PETITIONS

Habeas Corpus:
- ☐ 463 Alien Detainee
- ☐ 510 Motions to Vacate Sentence
- ☐ 530 General
- ☐ 535 Death Penalty

Other:
- ☐ 540 Mandamus & Other
- ☐ 550 Civil Rights
- ☐ 555 Prison Condition
- ☐ 560 Civil Detainee - Conditions of Confinement

FORFEITURE/PENALTY
- ☐ 625 Drug Related Seizure of Property 21 USC 881
- ☐ 690 Other

LABOR
- ☐ 710 Fair Labor Standards Act
- ☐ 720 Labor/Management Relations
- ☐ 740 Railway Labor Act
- ☐ 751 Family and Medical Leave Act
- ☐ 790 Other Labor Litigation
- ☐ 791 Employee Retirement Income Security Act

IMMIGRATION
- ☐ 462 Naturalization Application
- ☐ 465 Other Immigration Actions

BANKRUPTCY
- ☐ 422 Appeal 28 USC 158
- ☐ 423 Withdrawal 28 USC 157

PROPERTY RIGHTS
- ☐ 820 Copyrights
- ☐ 830 Patent
- ☐ 840 Trademark

SOCIAL SECURITY
- ☐ 861 HIA (1395ff)
- ☐ 862 Black Lung (923)
- ☐ 863 DIWC/DIWW (405(g))
- ☐ 864 SSID Title XVI
- ☐ 865 RSI (405(g))

FEDERAL TAX SUITS
- ☐ 870 Taxes (U.S. Plaintiff or Defendant)
- ☐ 871 IRS—Third Party 26 USC 7609

OTHER STATUTES
- ☐ 375 False Claims Act
- ☐ 400 State Reapportionment
- ☐ 410 Antitrust
- ☐ 430 Banks and Banking
- ☐ 450 Commerce
- ☐ 460 Deportation
- ☐ 470 Racketeer Influenced and Corrupt Organizations
- ☐ 480 Consumer Credit
- ☐ 490 Cable/Sat TV
- ☐ 850 Securities/Commodities/ Exchange
- ☐ 890 Other Statutory Actions
- ☐ 891 Agricultural Acts
- ☐ 893 Environmental Matters
- ☐ 895 Freedom of Information Act
- ☐ 896 Arbitration
- ☐ 899 Administrative Procedure Act/Review or Appeal of Agency Decision
- ☐ 950 Constitutionality of State Statutes

V. ORIGIN *(Place an "X" in One Box Only)*

☒ 1 Original Proceeding ☐ 2 Removed from State Court ☐ 3 Remanded from Appellate Court ☐ 4 Reinstated or Reopened ☐ 5 Transferred from Another District *(specify)* ☐ 6 Multidistrict Litigation

VI. CAUSE OF ACTION

Cite the U.S. Civil Statute under which you are filing *(Do not cite jurisdictional statutes unless diversity)*:

Brief description of cause:

VII. REQUESTED IN COMPLAINT:

☒ CHECK IF THIS IS A **CLASS ACTION** UNDER RULE 23, F.R.Cv.P.

DEMAND $

CHECK YES only if demanded in complaint:
JURY DEMAND: ☐ Yes ☒ No

VIII. RELATED CASE(S) IF ANY

(See instructions): JUDGE DOCKET NUMBER

DATE 9/25/13 SIGNATURE OF ATTORNEY OF RECORD [signature]

FOR OFFICE USE ONLY

RECEIPT # AMOUNT APPLYING IFP JUDGE MAG. JUDGE