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The Economics & Regulation of Payday Lending

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Payday Lending: Realities and Challenges,

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Payday Lending in a Nutshell

***Whatever the situation, getting a
cash advance of \$100 or more at
National Cash Advance is quick,
easy, and hassle free. Simply write
us a personal check. We'll
advance you the cash today and
hold your check until payday***

Setting the Table

- Is PDL an essential service involving willing customers and firms addressing short-term credit needs, or does industry encourage habitual borrowing & snowballing of unaffordable debt requiring state intervention?
- Does ban of PDL curtail unnecessary borrowing or force consumers to go underground or seek more costly sources of credit?
- Given seemingly high returns on PDL, why aren't mainstream banks more active players in this market?

Payday Lending is Part of the Subprime Market

(NC State Employee Credit Union Salary Loan Product Records)

Credit Score	Percent
Over 620	10%
560-619	21%
500-559	38%
Under 500	26%
No Score	5%

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What the Fighting is all about

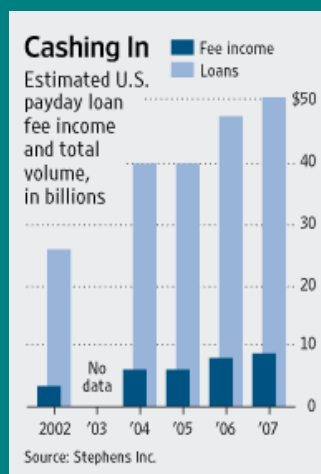
PDL industry in a state where law limited fees to \$15 per \$100 borrowed for maximum of 31 day term

Term	Percent of Loans	APR Range
1 to 7 days	7.4%	6441% - 920%
8 to 14 days	52.8%	805% - 460%
15 to 21 days	21.9%	429% - 307%
22 to 28 days	7.2%	293% - 230%
29 to 31 days	10.7%	222% - 208%
Total	100.0%	

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Standing Against the Wind

- Growth has slowed from 2004 when industry was opening about 100 new payday loan outlets a month, but
- From ~22,000 outlets in 2005 to ~24,000 outlets today.
- Despite increasingly hostile regulatory environment, 19 million households took out a PDL in 2007.
- Always seeking new markets-5 percent of University of Arizona freshmen took out a payday loan in 2007.



The Business Model of Payday Lending

- Transaction/fee-based business—maximize revenues by maximizing traffic
 - highly accessible locations, long, convenient hours, welcoming, but secure environment, cultural sensitivity;
 - Menu of products/services to attract street traffic;
 - Most important contribution to revenues is # of customers;
- 2nd most important variable is percentage of chronic borrowers—rollovers is a key to profitability:
 - NC 13+ loans/yr = 18% of customers & 40% of revenues

Despite High APRs, the Problem Boils Down to Repeat borrowing

- Because of high fees, after several renewals, borrowers can owe more than amount originally borrowed. IN -- 77 percent of payday loans are rollovers--average customer takes out more than 10 loans per year;
- CA -- customers average 11 payday loans/year;
 - IL -- customers average more than a loan a month;
 - NC -- average was 7 loans/year, while 27 percent of borrowers took out 13+ loans (before PDL banned).

Increasingly Challenging Regulatory Environment

- 17 states use “nuclear option” to effectively prohibit PDL (outright or $\leq 36\%$ APR)
 - In 2006, Congress capped rates for payday loans at 36 percent for military personnel.
 - Since Oregon passed 36% payday loan cap in 2007 about three-quarters of the state's ~330 payday lenders have closed.
 - Since Arkansas Supreme Court enforces 17% APR, PDL outlets declined 86%
 - With Nov 4 defeat of Prop 200 in Arizona, the current payday loan law will sunset in 2010, restoring the state's 36% small loan rate cap
 - But not counting Arizona, 37 states continue to cap APR at 300% or more, including 7 that have no caps.

Other States Regulate with Less Malice

- Cap APRs at higher levels;
- Attempt to limit rollovers and repeat borrowing; monitor with statewide database;
- Mandate cooling off period, installment plans;
- If all else fails, use nuisance law & local zoning code to limit concentration or presence of PDLs in certain locations.

NC-State Employees Credit Union Proves Low-Cost PDL Product is Feasible at Scale

The Product

Salary Advance Loan (SALO)

- Up to \$500, direct deposit of salary, automatic repayment next payday;
- 12.00% APR, max. = \$5/month
- Avg. borrower income \$2124 month (~\$25,500/yr);
- Mandatory 5% deposit of SALO in savings account;
- No more SALOs for 6 months if savings drawn down

The Experience

- Total Customers since inception in 2001: 103,000+
- Total advances: 103,625
- Total funds loaned: \$1.2 billion
- 65% of SALO customers take out monthly advance.
- Current 60 day delinquency: 1.65%.
- 2008 charge-offs 0.22% of loaned amount.
- \$14.7 million in savings accounts, w/1000+ members having \$1000+ balances.

Why don't More Mainstream Banks do SALO-Type Products?

- Banks nearly quadrupled their fee income in the last decade, while credit-card late charges and over-limit charges have nearly tripled.
- Banks made \$36 billion in 2006 on checking/savings account fees.
- Case in Point:
 - In 2007 Bank of America raised fee charged on the first day a customer overdraws to \$25 from \$20.
 - Also raised number of times customer can be hit with this fee per day to seven from five.
- In 2005, FDIC Chair said the "enormous" fees earned on overdraft programs discourage credit unions and banks from offering payday loans.
- 2006, GAO to Congress on Bank Disclosure of Fees:
 - *We Encountered Difficulties in Obtaining a Comprehensive List of Fees or Terms and Conditions during Our Visits to Depository Institution Branches and Web Sites*

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*So, that's my story and I'm
Sticking with it!*

Let the day begin