Payday Loan Industry Report

2010 Statistical Analysis of Pros and Cons

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Abstract

The intent of this document is to shed some light on the debate over the payday lending industry. As a provider of alternative lending products it can easily be misunderstood. There is a growing body of reliable research on the topic, though not as extensive as what exists on the first tiers of the finance system, such as the banking, stock market, mortgage and other financial industries. Many claims about the industry have been made, including that it’s "loan sharking" and "predatory lending," and others argue the industry fills a necessary niche and has economic roots so deep that it has always been an integral part of all economic systems that have ever existed.

Findings

Study of the payday lending industry can be flawed, as the difference between check cashing and payday lending is a line easily blurred. Check cashing services are used by two distinct economic groups, the unbanked, and the underbanked. The underbanked are defined as people that have a transaction account (e.g. a checking or savings account or both), but still use Alternative Financial Service Providers or AFSPs. The unbanked are those who do not have a transaction account of any kind. Payday lenders, since they require proof of employment or income, and a check to secure the loan, do not loan to the unbanked. Their province is entirely the underbanked, which is less than 20 percent of the U.S. population.

Check cashing establishments have added payday loans as a financial product but payday loans do not make up the bulk of their business. The check cashing market must cater to demographic populations who are unbanked, which typically include economically challenged individuals in lower income neighborhoods. Check cashing establishments would naturally have locations in geographical areas with higher population densities of the unbanked who need a non-bank to cash their checks, transfer money to friends and relatives, and purchase debit cards to conduct non cash transactions. These types of transactions are generally prohibited by banks to unbanked populations or are provided at very high costs. Typically they only offer these types of services to their account holders. Overlooking these facts have accidentally caused conductors of payday loan studies to draw statistically irrelevant correlations between poor unbanked populations and payday loans.

Payday lending is a new form of an ancient practice, replete with a new name. A person has a financial shortfall, and has to cover expenses until their next windfall or pay date. There always has been similar lending in one form or another, and therefore it is reasonable to assume that demand for short term credit is a constant in non-planned economies.

The typical payday loan is between $300 and $400, and the typical fee assessed is $15 to $20 per $100 loaned. Lenders are mandated to disclose fees as Annualized Percentage Rates, or APR, as well as dollar amounts. A majority of payday lenders belong to one of three major trade organizations, which maintain a code of "best practices" including full disclosure, among other standards of practice. These organizations are the Community Financial Services Association of America, the Online Lenders Alliance, and the Financial Service Centers of America.

The average payday loan borrower is not what one could be led to believe. The estimates of income range from $20,000 to $50,000 for most borrowers. Some demographic studies indicate that nearly 50% of payday loan borrowers own their homes, and most have a high school education or more. The average age is between 20 and 40. The most liberal estimates of payday loan use indicate that 20 % or fewer of the American population have actually used a payday loan.

The average borrower is the near epitome of the middle class American, which does not make up the majority of the U.S. population due to the shrinkage of the middle class in general. The demographics of payday loan use also differ between online payday loan borrowers and store front borrowers. In fact, more than 50% of a sample of 736,369 online applicants who applied June 10 to July 11 of 2010 own their own home and make an average of $41,753 annually. Out of those applicants, the ones who passed initial underwriting criteria for approval, 45.2% owned their own home and made an average of $47,260 annually.

Some well intentioned consumer advocacy groups, who wish to do away with the industry, paint the picture that payday loan borrowers are all minorities, too poor to repay the loans they borrow and are generally financially desperate. They also purport that lenders know this and purposely lock poor people into a never ending cycle of debt. This is not the case, and if it were, no payday lender would remain in business long. These unfounded conclusions have been drawn from studies that more accurately describe the demographics of unbanked check cashing customers.

Overview of payday loan industry

Short term consumer financing is not a new phenomenon. In and of itself, payday lending is simply a modern term for the old practice in early American history of lending to miners, farmers and factory workers so they could feed their family between pay periods. This type of lending dates back as far as recorded history goes and the need for a stable supply of credit played an important role in the development of the modern elastic currency system.**(Greenspan Speech)**

State laws providing a usury ceiling used to be lower than 10 percent nationally,**(Elliehausen 2001)** but because such great demand grew for the antecedents of the modern payday loan industry, the interest rate caps were raised as to make the practice safer. As a result, illegal lenders ("loan sharks" and other illegal lenders) either became legitimate small loan, chattel mortgage or pawn lenders, or were driven further underground. Illegal underground lending continued, but more people had legal avenues to pursue to meet these demands.

In the US, the current payday loan industry sprouted from an economic vacuum in the short term credit markets, as sources of short term credit dried up. One of the usual ways people obtained credit for goods they could not afford, especially sundries and groceries, was through "tabs" at local stores. Before department stores or supermarkets, general stores and grocers were almost always locally owned and operated. Customers and their situation financially were known well to shop keepers.
On these economies of smaller scale, customers waiting for a harvest to come in or sales to be made or forthcoming wages, would have a running tab for things they needed, like seed, a wagon axle, or whatever might be absolutely necessary that they couldn't afford at the time.

When the harvest finally came in, the tab would be paid off, or trade made for comparative value. Credit, from local banks or financiers, would only be extended for obtaining something of value, such as additional parcels of land. Financing for consumer items, such as a piano or sewing machine towards the end of the 19th century, was by "layaway," or by down payment plus a series of installments. Layaway or installment programs, now seen as almost anachronistic due to the emergence of credit cards, were once the rule rather than the exception. **(Fed Res. Bank of Boston.)**

Traditional banks and credit unions do not offer much in the way of low risk consumer options. The alternatives to payday lending through mainstream financial institutions, such as overdraft protection, open lines of credit and other products are typically more expensive and harder to obtain. They certainly cause far more damage to a person's financial standing in cases of default. If payday lenders were to switch to the methods of mainstream financial service providers, they would not be able to stay solvent.

The void that payday lenders filled after the market was abandoned by finance companies were precisely for people who weren't able to secure financing from banks. **(Elliehausen 2001)** As such, payday lenders are also not afforded protections mainstream institutions enjoy, such as FDIC backing or bailout funding. This translates into very low credit risks for borrowers which is a significant benefit ignored by proponents and purposefully omitted by advocates. Many informed borrowers simply refuse to pay payday lenders according to their terms knowing those lenders have very little in the way of financial recourse in cases of default.

In most cases though, alternatives to payday lending are simply not available to people who have either no credit history or a poor credit rating **(Elliehausen 2001)**. Some simply chose not to continuously have their credit score lowered as multiple instances of applying for credit with traditional institutions cause "hard inquiries" on their credit reports. As finance companies and banks shifted their focus on consumer finance to mortgages, auto loans, and credit cards, the number of short term, small dollar lenders outside of pawn shops dwindled. Mainstream financial institutions possibly left the small unsecured lending market because of the high costs and massive default rates, as well as the larger profits inherent to larger loans (**Elliehausen 2001).**

The average type of individuals who actually utilize these types of short term credit products are not in the US majority nor are they poor minorities. The usual payday customer has at least one transaction account (required for approval) with a bank or credit union and cannot be defined as a member of the "unbanked" populations. In other words, consumers rely on payday lenders for a reason, and the most likely reasons are that, either they do not wish to or cannot use traditional bank credit, or payday lenders provide a more attractive loan product. Most studies of borrower demographics indicate that payday loans are used to cover emergency expenses, unexpected bills, medical costs and even recreational spending (**Elliehausen 2001**). The number of people that borrow from payday lenders is not very high.

There has always been a certain segment of the US population who cannot or will not fulfill their basic financial needs using mainstream banking and financial service providers. They are referred to as the "under banked" and the "unbanked." The difference between the two is that the unbanked have, by definition, no transaction accounts at all and can't secure a payday loan, as they have no checks to post date or account numbers to offer as security via debit authorization. The FDIC and the Federal Reserve define the "under banked" as people who have a transaction account (e.g. checking or savings accounts) but still utilize alternative financial services (AFS) in order to obtain the products they need.

Since nearly the dawn of the industry, there have been calls to regulate payday lending, and some states have regulated it out of existence in their jurisdictions. Negative economic effects have been observed from these bans, such as greater rates of check bouncing and debt collections. (**Morgan and Strain 2008)** Given the historical context of the industry and previous prohibitions such as the ban on alcohol, show that the intent may be noble but the results have not been positive. Turns out that smart people know how to drink responsibly and smart borrowers know how to use credit.

The studies that have been done on the payday lending industry appear to indicate that payday lenders are not what some opponents and proponents make them out to be. Payday lending, whether online or through a traditional storefront lender, cannot be empirically or morally called predatory. Customers usually know exactly what they are agreeing to. Also, the disclosure of the APR on payday loans is misleading, as an annual percentage rate would be ill-applied to a loan that matures in a matter of weeks or days, rather than years. Contrary to what some dissenters say, payday lenders do not target customers based on race, or at least there's little in the way of conclusive evidence that they do.

Payday lenders have to charge the fees that they charge, which aren't as astronomical as some opponents want you to believe. Payday lenders are exposed to a greater risk when lending and actually therefore have an extensive screening systems and ridged lending standards for borrowers. They do not automatically approve anybody with a bank account and a pulse. Not only do they have greater risks involved in lending, they also do not have the astronomical profits that a credit provider often called "exploitative" is expected to have.

Consider the events of Prohibition in the early 20th Century: In order to keep citizens "safe" from the evils of imbibing alcohol, the production, distribution and consumption of alcoholic beverages was prohibited legally. Instead of making for a safer and better society, the crime rate skyrocketed, especially violent crime, and criminals were the prime beneficiaries of that legislation. Prohibitionists may have had good intentions, but the relative "profits" of the legislation were realized by Al Capone, not John Q. Public. Loan sharks do exist. They have hurt real people. Small dollar, short term consumer lending should be legal and available in order to protect people from having to turn to that option.

It's true that some lenders have engaged in dishonorable practices. For instance, some have used aggressive collection practices, but internal efforts are present within the industry to prevent that and make customers more aware of their rights than other industries have attempted to. The Community Financial Services Association of America (CFSA), and the other trade organizations of the payday lending industry such as the Online Lenders Alliance (OLA) and the Financial Service Centers of America (FiSCA) maintain strict guidelines in their "best practices," which include the disclosure of all terms up front, a standard of transparency one would never expect of a credit card. (do not think so? Read the back of a credit card offer.) Not every payday lender is a member of these trade organizations, but given that just more than 50 percent of the payday loan industry does belong to the CFSA, this indicates a majority of the industry is more ethical than one could be led to believe by some of the industry's critics.

The industry has undergone numerous changes in its short time in existence. There are a growing number of lenders, some that exist entirely online, bypassing the need to operate a brick and mortar store altogether.

About Us

PersonalMoneyStore.com is an advertising website that generates applications for the financial services industry, a component of which is generating leads for the online payday lending industry. We acknowledge that we have a financial stake in the payday loan market. Although, since we are not a lender nor do we have competing interests, we have a unique perspective and a voice backed by statistics not heard in the current payday loan debate. Whether the industry becoming restricted or banned by further legislation helps or hurts the online lead generation for the lending industry is debatable. Many online borrowers seek loans outside of jurisdictions that currently ban or heavily regulate them.

We firmly believe that factual evidence indicates that the payday loan industry, both online and traditional in its current form, is the most beneficial option for many consumers to meet their demand for alternative financial services. We believe consumers are best served by having freedom of financial choice and access to information about lending products and service they desire to use. To that end we provide the public with a financial news and information blog that averages over 300,000 visitors per month. Our writers cover a broad range of topics including personal finance, financial and business news, U.S. and world events, and of course news concerning the payday lending industry. Coverage includes academic studies of the industry as they emerge and newly passed or pending legislation.

Published Statistics

Personal Money Store is not an online payday lender, but only generates leads for the online payday lending industry. The leads Personal Money Store generates are fed into a lead management system, also called a lender matching system, which in turn feeds other lead aggregators as well as direct lenders nationwide, where they can purchase those leads that meet the criteria of their underwriting systems. This provides applicants in all 50 states with a high chance of finding a lender willing to approve them considering jurisdictional issues, legal restrictions on some lenders and their geographical areas, income levels, types of employment, and general demographic requirements.

As a corollary, several leads or applications the system deals with could be the same person, and not every lead purchased by one or more lead buyer results in a loan. These numbers are from the lead management system as a whole, and are not representative of Personal Money Store exclusively in application volume, rejection rate or approval rate. Furthermore, not every lead processed results in a funded application, nor is every application lead always unique.

The activity from June 10 to July 11, 2010, for the entire lead managing system, of which Personal Money Store is only one component, revealed the following data:

- 736,369 applications were processed
- 728,813 applications were rejected
- 7,556 passed initial underwriting criteria and were purchased

Of all processed applications across the entire database, only 1.02 percent of them were actually accepted. The rejection rate numbers could be misleading, though, because it is not known what proportion of the applications processed are duplicates, what number of rejected leads are duplicates, or how many of the leads purchased for the intention of making a loan resulted in a loan being made to a customer. The exact proportions of direct lenders, aggregators, and affiliates is unknown, or not able to be disclosed.

One of our affiliates generously provided us with a 60 day data sample, from mid-May to mid-July, 2010. Here is what they found:

- Average rate of acceptance: 0.33%
- Amount of duplicate (multiple applications from the same applicant) applications: 45.4%

Less than 0.5% of applicants were approved on average over the 60 day period.

Customer Demographics

The lead management system also keeps track of customer demographics. The average online payday loan applicant in the lead management system:

- Is 38 years old.
- Makes $41,753 per year.
- Has been employed for the past two years.
- Has been at current address for three years and two months.
- Has a 50 percent chance of being a home owner.

However, the average online borrower whose application was purchased is a little different:

- Average age is 36 years old.
- Makes $47,260 per year. (Slightly above U.S. GDP per capita.)
- Has been employed for the past four years.
- Has been at current address for three years and seven months.
- Has a 45.2 percent chance of being a home owner.

Our affiliate provided the following information about the applicants they approved:

Pay Frequency:

- 68.6% were paid biweekly
- 15.8% were paid twice per month
- 7.2% were paid every week
- 8.4% were paid monthly

Source of income
- 0.21% were pension recipients
- 1.21% were Social Security recipients
- 0.09% were on unemployment
- 2.18% were on disability benefits
- 96.3% were employed
- 0.06% were self employed

Bank account they used to apply with
- 0.76% applied using a savings account
- 99.24% applied with a checking account

Direct Deposit of income
- 4.44% did not receive their income via direct deposit
- 95.56% received their income via direct deposit

Active military personnel
- 0.12% were active duty military
- 99.88% were not active duty military

Rental or ownership of residence
- 74.37% of applicants owned their own home
- 25.63% rented

Geographic distribution by time zone
- 50.76% of accepted applicants resided in the Central Time Zone
- 31.92% were from the Eastern Time Zone
- 11.58% were from the Pacific Time Zone
- 4.78% were from the Mountain Time Zone
- 0.67% were in Hawaii
- 0.21% were in Alaska
- 0.06% were from the Atlantic Time Zone (4 hours behind GMT, 1 ahead of Eastern)
- 0.03% were from Other

Age
- Minimum age is 18
- Maximum age is 83
- Median age was 40
- The bottom 25% were 32 years or younger
- The top 25% were older than 47
- The greatest number of accepted applications were between the ages of 33 and 46

By State
- Texans accounted for 20.83% of accepted applications
- Californians accounted for 9.52%
- Maryland residents accounted for 8.37%
- Missouri residents accounted for 8.34%
- Floridians accounted for 7.16%
- Louisiana residents accounted for 4.23%
- The area with the highest rate of acceptance was the U.S. Virgin Islands, with 6.12% of applicants from there being accepted, though they made up 0.09% of the accepted applications.

This would suggest several things about online payday lenders and online payday borrowers. First, online payday lenders are dramatically more selective than brick and mortar lenders. Second, the average online payday borrower makes a middle class income, has a steady employment history and is more likely to have some definite roots in their community. Also, the average applicant makes $5,507 less than the average approved applicant, so online lenders peg approval to income level more than anything else. Because payday lenders rarely (if ever) check FICO scores, the debt-to-income ratio is not available to them, and the best metrics for establishing an ability to repay is checking TeleTrack or CL Verify and applicants' income level.

Traditional vs. Online Payday Loan Lenders

Since the Internet has made commerce accessible to anyone with a connection, payday loan lenders have also gone online. There are differences between a traditional brick-and-mortar payday loan store and an online payday loan lender, in the underwriting requirements and also the risks.

Brick and mortar payday loan stores

A traditional payday lender underwrites a loan first by securing it with a postdated check from the borrower. The borrower has to furnish proof of identity, proof of a bank account and proof of income. The lender then accepts a post dated check, and hands over the cash. Essentially, customers have only to prove their identities, give an address and phone number, and then prove they have a bank account and a job to obtain a loan. However, some storefront lenders have underwriting software and subprime credit databases they can check the borrower against, for instance TeleTrack or CL Verify. In order to open a store in any given area, a traditional lender has to get the appropriate licensing and comply with local, state and national laws.

Online payday lenders

Online lenders work a little differently. Online lenders must first be able to transmit the funds to the borrowers, by sending them a prepaid debit card or by depositing funds into customers' bank accounts. To do that, the lender must verify the applicant's bank account is in good standing, and some lenders may require the borrower to fax them bank statements. Lenders can also only make deposits in accounts that have already authorized direct deposits. In order to establish that a prospective borrower is not an outrageous risk, lenders have to be able to establish that a borrower has a stable banking and employment history. They also check the borrowers' history with other payday or other subprime lenders by checking one of the subprime credit databases, e.g. Teletrack or CL Verify.

The regulation of online lenders differs as well. Unlike a traditional payday loan store, which has to conform to the laws of the area in which it is located, an online lender can "shop" for jurisdictions in which to headquarter itself in order to take advantage of the laws pertaining to that state. Online payday lenders also may have to tailor loans according to interstate agreements. For instance, an online payday lender in South Dakota, if they are lending to an applicant in Florida, has to loan according to Florida rules on payday lending, if South Dakota has an agreement in Florida to enforce Florida's laws when businesses in South Dakota engage in commerce with businesses or consumers in Florida.

Risks involved

The largest risk for a payday lender is default. Comprehensive data does not exist on the rate of defaulting on loans or on late payments, as the industry is largely privately held and many private entities are hesitant to publish their financial records, which in the case of the payday lending industry, has been acknowledged many times over. Losses could account for as much as 25 percent of operating costs, at least for traditional payday loan stores.**(Huckstep)** The average payday lender in a survey of FiSCA (Financial Service Centers of America) members that offered payday loans charged $15.26 per $100 loaned, and of that $15.26, $3.74 of the fee went toward bad debts.**(Ernst and Young)** This would imply that perhaps up to a fifth of loans among traditional lenders is not repaid. No bank or credit union would touch a market segment in which one in five loans would be lost. The default rate for online lenders in unknown, as little in the way of study is available for online lenders.

Another risk is that payday lenders have fewer options for recourse if a customer defaults. The average loan is between $300 and $400, and payday lenders cannot garnish wages as other lenders (credit cards, student loans, etc) can, so they can do little outside of taking the delinquent customer to court. Because the average payday loan is such a small amount, there is usually no point in taking customers to court as the garden variety attorney charges hundreds of dollars an hour, plus other costs which can include considerable court costs. Therefore, some debt is going to be totally unrecoverable, meaning that lenders face a guaranteed loss at some point. Online lenders face perhaps the greatest risk, as they have no community presence (no "face" to put on the name) and can be without any means of collection if a customer decides to take the money and close the bank account.

Furthermore, since payday lenders, online or otherwise, lend "subprime" credit, there are fewer negative repercussions for customers who default. A credit card company, in case of default or late payment, can report a customer to the credit bureaus, such as Experian, Equifax, TransUnion, and then a negative report will appear on a customers' FICO history, and their FICO score will lower accordingly. The threat of a ding on a credit report is that a person will be less able to secure financing for large purchases such as a car or a home. If a payday lender reports to either CL Verify or to TeleTrack, it only affects customers if they try to borrow other subprime credit, and not every lender reports to those agencies. Oddly enough, one of the constant criticisms of the payday lending industry from the Center for Responsible Lending and others is that they do not check credit scores like banks and credit unions. Given the history of payday lending, it was precisely the lack of short term credit available from traditional lenders such as banks that led to the industry arising in the first place.

Any and all attempts to collect a debt through third parties are bound by the Fair Debt Collection Practices Act. This is not to say that all lenders stick to the FDCPA as a guideline, as many do not refer their bad debts to collection agencies. There are lawsuits that have been successfully brought against payday lenders as a result of illegal debt collection practices. That being said, there are efforts within the industry to do away with illicit collection tactics. The Community Financial Services Association of America, a trade group for payday lenders, check cashers and pawn brokers, as well as the Online Lending Alliance, have a policy of using "best practices," a code of ethics of sorts by which their members agree to operate. Part of the "best practices" of both the CFSA and the OLA include up front disclosure of the terms of loans and an agreement to use the Fair Debt Collection Practices Act as the standard for collection practices. However, not every lender opts to join, as membership fees can be considerable.

The idea that payday lenders, online or traditional, approve any applicant regardless of worthiness is a falsehood. One study found that up to 20 percent of traditional (store front) payday loan applicants are rejected their first time applying, and 11 percent of applicants are rejected overall. **(Skiba, Tobacman 2007.)** and a sample of online lenders (discussed below in Statistics) revealed that only 1.02 percent of online payday loan applicants are actually approved to be viewed by lenders, though how many of those approvals resulted in the deposit of funds is unknown.

Legislation Regulating Payday Lending

There has been legislation passed on payday lending on nearly every level. There are Federal laws and guidelines regulating the practice, as well as state regulation and laws passed regarding payday lending on tribal lands.

Federal Legislation

Recently, the 2010 Financial Reform Bill included an amendment, called the Hagan Amendment (the sponsor/author of the amendment was Senator Kay Hagan of North Carolina), which would have restricted the number of payday loans a customer could take out to six per year, which failed. Numerous other attempts have been made to federally regulate payday lenders, none of which have been successful except for the Talent Amendment, part of the John Warner National Defense Authorization Act for Fiscal Year 2007, which prohibits any lender of any sort lending to any member of the Armed Forces at anything more than 36 percent interest. As of the time of this writing, payday lending may fall under the jurisdiction of the Bureau of Consumer Financial Protection.

Aside from the Talent Amendment, there is other legislation that affect payday lenders. The Truth in Lending Act requires them to disclose information about fees and interest rates up front, for instance, and any and all other federal statutes applicable to financial services. Aside from the appropriate federal legislation, the bulk of regulation of payday lenders happens at the state level.

State Legislation and Regulation

As financial service providers, payday lenders have to conform to the laws of the state in which they reside. The laws that govern payday lenders vary by state. Some states may categorize payday lenders under Banking and Finance, some may not. Currently, no state is devoid of regulations altogether, and the least regulated states for payday lenders often mandate only that lenders comply with small loan laws. The majority of states that allow payday lenders to operate have some sort of regulatory restrictions in place. Other states either explicitly prohibit them, or de facto prohibit payday lenders by means of a usury rate cap.

The states that do not cap interest rates, the amount of the loan or length of the repayment periods are Connecticut, Maine, New York, North Carolina, Utah and Vermont. Lenders in these states are legally able to charge as much as a borrower will agree to but they have to comply with the existing small loan laws.

States that *only* cap the *amount* that can be borrowed are Idaho, Nevada, and South Dakota. Idaho caps payday loans at $1,000, Nevada at 25 percent of the borrowers' expected monthly gross income, and South Dakota caps payday loans at $500. Aside from having to conform to small loan laws, lenders can choose to charge as much as any borrower will agree to pay.

Some states specifically ban "payday lending" or do not allow payday lenders to legally operate by either the existing usury ceilings or newly passed usury ceilings, which makes the business untenable. The states where the usury limit excludes payday lenders from being able to operate are Georgia, Oregon, Pennsylvania, Maryland, Massachusetts, West Virginia, Puerto Rico and the Virgin Islands. Georgia also partially includes payday lenders in their RICO statutes.

All other U.S. states, and Washington D.C., have regulations in place which govern the maximum or minimum length of time the loan can be made for, the maximum amount that can be borrowed and the maximum amount of interest or fees that can be assessed. The nature of the state legislation varies by state, as some are less restrictive than others. Legislative changes in payday loan regulation occur every year. Legislation also takes place on the city level with zoning ordinances. Some towns and cities determine how many payday lenders can operate in that city, where they can locate within an area, how they can advertise and so forth.

Tribal Regulation

Some lenders have registered as businesses on tribal lands. As such, they have the protection of a legal doctrine known as sovereign immunity. Sovereign immunity dictates that some bodies, typically governments, are immune to prosecution without their consent. As an example, say a person was drafted into the Armed Forces to fight in a war. During the course of that service, the draftee is killed in action. The government cannot be sued for wrongful death by the family of the deceased unless the government consents to be sued, as the federal government has certain immunities, as a sovereign entity, from lawsuit and prosecution as well as protections from other tort acts. (For instance the Tort Claims Act, and the doctrine of Feres v. United States in the case of the death of military personnel.)

Sovereign immunity also applies to state governments and to Native American tribes and nations. Thus, any business that is located or headquartered within the borders of a reservation is technically bound by the laws of that reservation and not the state that the reservation is surrounded by. Some online lenders have taken to registering as corporations on tribal lands to take advantage of this protection. In other words, if payday lenders on tribal lands engage in practices that would be illegal if not located on tribal lands, they cannot be sued as they have sovereign immunity. Conversely, they may not be able to, depending on the exact statutes in the state the person resides in, sue a delinquent borrower, as the delinquent borrower is not subject to tribal jurisdiction. Numerous complaints and several lawsuits have been brought over just this activity. In some instances borrowers have gotten out of paying the tribal lenders anything at all, not even paying back the principle.

The Lobbies

All information regarding lobbying, political action committees (PACs), campaign contributions and so forth, are all from the Center for Responsive Politics, and their website, Opensecrets.org. The CRP gets their information from the United States Senate Office of Public Records, the Federal Election Committee, and the Internal Revenue Service.

Both consumer advocate groups and others backed by large banks lobby the state and federal legislatures. Among the advocates against payday lending are a wide range of groups, such as the Center for Responsible Lending, the National Consumer Law Center and the Consumer Federation of America. There are numerous other groups that are affiliated with the CRL and the NCLC, and have called for banning the industry entirely, or alternatively, for far more stringent regulation. Two of the highest profile champions for either bans or more stringent regulations of payday lending are Jean Ann Fox, of the Consumer Federation of America and Uriah King, of the Center for Responsible Lending. Both Fox and King have testified before state and federal legislatures about the "evils" of payday lending citing studies primarily focused on check cashing establishments that also offer payday loans.

The Center for Responsible Lending was launched in 2002, from its parent organization, the Self-Help organization. Self-Help was launched in 1980, as the Community Center for Self-Help by Barbara "Bonnie" Wright and Martin Eakes. It branched off into a Self-Help Credit Union, Self-Help Federal Credit Union and Self-Help Venture Fund. They have locations in North Carolina, California, and Washington D.C. The main focus of the CRL is finance, especially consumer finance, and the group lobbies Capitol Hill along with businesses to promote fair lending practices. CRL has testified before both state and federal legislatures, advocating for financial reform for nearly every area of consumer finance, including short term credit, overdraft and banking policies, credit cards, payday loans, refund anticipation loans and mortgages.

The Consumer Federation of America has been around since 1968 as a non-profit consumer advocacy group. It has over 250 affiliated organizations that total over 50 million members. A few of the organizations affiliated with the CFA are Americans for Financial Reform, the AARP, the AFL-CIO, the SEIU, the NAACP, the International Brotherhood of Teamsters, Accountable America, Demos, MoveOn.org and the National Council of La Raza, just to name a few. The CFA employs three lobbyists, according to OpenSecrets.com, to the tune of $30,000 so far this year. Neither the CFA, nor the CRL or the CRL's parent organization Self Help, make campaign contributions as in their organization's name, or at least not sizable enough contributions to be noticed. Self-Help only spent $20,000 on lobbying in 2010. However, some of the affiliated groups, such as the Teamsters Union and the Service Employees International Union (SEIU) are heavy campaign contributors, mainly to Democrats. The SEIU donated more than $2 million to election coffers on the federal level in 2008, including more than $74,000 to Barack Obama.

Given the association that the main lobbies against payday lending have with unions, one could assume that unions are squarely against payday lenders and against AFSPs, and donate heavily to candidates that oppose payday lending. This is not universally the case; the candidates discussed in the following section all received comparable amounts if not more from organized labor and companies/industries that heavily employ organized labor. Unions actually do not heavily contribute to opponents of "pro" payday lending candidates, either.

The payday lending industry has its own lobbyists and trade organizations as well. The main trade organizations for the payday lending and alternative financial services (AFS) industry are the Community Financial Services Association of America (CFSA), the Online Lenders Alliance (OLA), and the Financial Service Centers of America. Interestingly enough, **payday lending and AFS trade groups donate to more Democrats than Republicans**, both by number of candidates and in dollar amounts donated.

The Community Financial Services Association of America, or CFSA, has been in existence since 1999. More than half the mainstream brick-and-mortar payday loan stores are CFSA members. Some payday loan companies that also lend online and offer other services such as check cashing are members of all three trade groups.

The CFSA held its first political action committee conference (on the federal level) in 2008, raising $200,300 and donating $168,000. The CFSA's PAC for 2008 donated $81,300 to House Democrats, $47,000 to House Republicans, $20,200 to Senate Republicans and $19,500 to Senate Democrats, for a 60-40 split between Democratic and Republican candidates. The PAC for the CFSA in 2010 raised $168,450, and spent $95,100. Candidates for the House of Representatives received $37,000 for Democrats and $10,000 for Republicans from the CFSA. Candidates for the U.S. Senate received $23,800 for Democrats and $19,500 for Republicans from the CFSA.

The CFSA also has employed lobbyists and lobby firms since the organization got off the ground in 1999, to the tune of $120,000 for that year. Since then, its spending on lobbying has increased annually, peaking in 2009 when the CFSA spent $2.56 million on 10 different lobbying firms.

The Online Lenders Alliance (OLA) was founded in 2002, and it has been maintaining an active role in lobbying Congress as well. The first OLA PAC was also held in 2006, and the group spent $3,100 out of the $75,000 raised, of which $1,000 went to another PAC, the Narrangasset Bay PAC, and $2,100 to the Patrick McHenry campaign. (McHenry is a Republican from North Carolina, currently in the House of Representatives.) The OLA, in the 2008 election, donated $45,300 to House Democrats and $28,400 to House Republicans, while Senate Democrats received a total of $21,200 and Senate Republicans received $15,500. OLA also gave $66,600 to other PACs. In 2010, the OLA's PAC spent $126,800 on campaign contributions, PACs, and other expenses.

The OLA picked up its first lobbyists in 2006, spending $60,000 on lobbying services. The peak years for OLA lobby spending were 2008 and 2009, and the group spent $480,000 and $520,000 respectively. The most constant presence in lobbying on behalf of the OLA has been Venerable LLP, a law firm and lobby group (many law firms, especially in the Washington D.C. area, have lobbying services as part of the services they offer) and the Polaris Government Relations/Polaris Hutton Group.

The other major trade association for payday lenders is the Financial Service Centers of America (FiSCA). The precursor to the FiSCA was founded in 1987 as the National Check Cashers Association, an industry that dates to the Great Depression era. As the AFS industry began to diversify beyond check cashing and money orders and into small loan products, such as payday advances or payday loans, the FiSCA took on a more diverse membership and morphed into the current organization over time. Today, the FiSCA has more than 1,300 participating businesses with over 7,000 different locations.

The FiSCA first began making contributions to candidates in 1990, and they have slowly increased contributions since then. The high water mark was in 2006, when they spent $157,967 on PAC and campaign contributions. The FiSCA has contributed more to Republicans historically than Democrats. In 2006, its heaviest contributing year, it contributed $29,000 to House Republicans, $15,500 to House Democrats, $10,650 to Senate Republicans and $10,000 to Senate Democrats. The FiSCA also employs Sellery Associates Inc. as its main lobbyists in Washington, D.C., though the group at times hired other governmental relation specialty firms as well. It has retained Sellery Associates, Inc. as its primary governmental liaisons since at least 1998.

Alongside the trade organizations, individual payday lending companies have made contributions to Congressional candidates on both sides of the aisle. There are seven publicly traded payday lending companies, referred to as the "Big 7." The Big 7 are Advance America Cash Advance Centers Inc., ACE Cash Express, Cash America International Inc., Dollar Financial Group Inc., EZCORP Inc., First Cash Financial Services Inc. and QC Holdings Inc. Each has its own PACs and lobbyists, as well as contributions to and membership in the FiSCA, CFSA and OLA.

Congressional Disposition

Some members of Congress are more amiable to the payday lending industry than others. Some are regular recipients of campaign funds from the payday lending trade groups and payday lending companies. In addition some also get contributions from proponents and competitors of the payday lending industry, like WellsFargo Bank, as well. Of the three major trade organizations that payday lenders belong to, those being the FiSCA, the OLA and the CFSA, at least two of them were contributors to the campaign coffers of Carolyn B. Maloney (D – NY), Bobby Rush (D – IL), and Heath Shuler (D –

NC), through Political Action Committees, individual donations from employees or executives of those companies and their family members or a combination. All information regarding lobbying, political action committees (PACs), campaign contributions and so forth is from the Center for Responsive Politics, and the website they maintain, Opensecrets.org. The CRP gets their information from the United States Senate Office of Public Records, the Federal Election Committee, and the Internal Revenue Service.

Representative Carolyn Maloney, first elected in 1989, received $42,500 in donations from payday loan industry lobbyists and PACS in 2010 so far. Donors included the FiSCA, the OLA, Advance America Cash Advance Centers, CNG Financial (Check N Go, a payday lending/check cashing company that's a CFSA member) and Cash America International. The contributions were a minor part of Rep. Maloney's total contributions, as she raised over $2.6 million in campaign funds. Her last opponent in an election, Robert Heim, did not appear to draw much in campaign contributions, as there is little data (if any) available. Her victory in that election was a near land slide, capturing over 70% of the popular vote. For the 2010 midterm elections, her opponent is Reshma M. Saujani, running as a Republican. He has not received any contributions from any PACs connected to the payday lending or AFS industry.

Representative Heath Shuler (D – NC), has received donations through PACs from the CFSA, the FiSCA, QC Holdings Inc. (QC Holdings is also a CFSA member), CNG Financial, First Cash Financial Services, Moneytree Inc. (FiSCA and CFSA member), Advance America Cash Advance Centers Inc. (also a CFSA member), Softwise (a major software developer for the check cashing/payday lending industry), EZCORP Inc., the DFM Group (OLA, CFSA, FiSCA member, as well the California Financial Service Providers, the American Collectors Association, and the Consumer Financial Education Foundation), Cash America International (CFSA member), USA Cash Services (CFSA member), GECC, Lead Flash (OLA founding member) and CheckSmart (member of the FiSCA, CFSA, Ohio Association of Financial Services Centers, California Financial Service Providers Association, Financial Service Centers of Florida, and Utah Consumer Lending Association). The payday lending industry contributed $57,900 to Rep. Shuler for 2010 thus far. His opponent in the 2008 election, Carl Mumpower, received no donations from the payday lending industry. Mumpower was soundly beaten and in fact wound up in debt as a result of the election.

Bobby Rush, a Democratic Representative from Illinois, received donations from the payday lending industry of $15,900 to his 2010 election campaign funds, from PLS Financial, Cash America, CashNet, and the FiSCA. In the past, he received donations from Advance America Cash Advance Centers, QC Holdings, the Capitol Hill Consulting Group (a firm that payday loan trade groups and the Big 7 retain for lobbying purposes), the OLA, First Cash Financial Services, EZCORP, Checksmart Financial, the CFSA and Check Into Cash. Congressman Rush does not face serious competition for his seat; his main opponent is a Green Party candidate, and since at least 2000 has not received any less than 80% of the vote. (There are currently no third party or independent members of the House of Representatives, and only 2 Independent Senators both of whom caucus with Democrats.) The payday lending industry did not contribute to his competition, as little in the way of actual competition for his seat seems to exist.

These aren't the only recipients of campaign contributions by payday lenders, nor are payday lenders the most common source of campaign contributions for these representatives. (Rep. Rush received more donations from utility and energy companies and organized labor than from the payday lending industry.) Other Representatives and Senators that have received campaign contributions from the payday lending industry include Representatives Pete Sessions (R-TX), Patrick McHenry (R-NC), Barney Frank (D-MA), Michelle Bachman (R – MN), Senators Chris Dodd (D – CT), Richard Shelby (R – AL), Tim Johnson (D – SD), Harry Reid (D- NV), Patty Murray (D – WA) and Senate Minority Leader Mitch McConnell (R – KY), among many others.

The more conspicuous opposition to the payday lending industry, such as the Center for Responsible Lending, the National Consumer Law Center and others, do not make contributions to candidates. The money they spend in Washington D.C. is entirely for lobbyists, who testify before and advise Congress on behalf of the interests and issues their organizations contend with. A clear cut "enemy" or opponent of the payday lending industry is almost indefinable, or rather, a competitor dedicated to driving them out of existence to reap the windfall of their exit from the market doesn't entirely exist.

One could surmise banks, credit unions, credit card and finance companies are the competition for payday advance business, but that isn't the case necessarily. Many payday borrowers are already overextended or close to it regarding their mainstream credit. Banks and credit unions also haven't been able to have a similar product and turn a profit. If it were the case that Bank of America hypothetically wanted to take over the payday loan business, they already would have. The amount of money B of A and other multinational banking entities are able spend on political candidates dwarfs the contributions the payday industry have made. For instance, Rep. Heath Shuler received $57,900 from payday lending organizations for his 2010 election fund. Senator Chris Dodd, by comparison received $152,100 from the Royal Bank of Scotland alone in 2010. If campaign contributions determined everything, and banks were out to drive payday lenders out of business, they would have done so long ago.

There are certainly some Representatives and Senators against the payday industry as well. Senator Kay Hagan (D – SC) authored the amendment to the 2010 financial reform bill that would have placed federal restrictions on payday lenders capping interest at 36 percent and limiting borrowers to six payday loans per annum. The amendment failed, but it may be the case that payday lenders will become the province of the Federal Reserve, if the proposed oversight agency is created **(Wall Street Journal)** .

The Payday Lending Debate

The debate over payday lending is whether lending at such a (perceived) high interest rate should be allowed and whether payday loans specifically could be classified as "predatory," or if payday lenders are truly providing a service to communities that have a demand for it. Whether supply and demand drive markets is not really open to debate. If a demand exists, a supply will rise to meet it. Scarcity, abundance and the cost of providing the goods or services in question determines the price. In the case of payday lending, there is a demand for short term credit, unsecured by property, in which a credit rating is not a factor. Arguments exist for both sides of the debate.

The Argument against Payday Loans

The debate over payday lending has been going on for some time, and it's unlikely to abate. Some of the most common criticisms of the payday lending industry are that the lending practices are predatory, interest rates are exorbitant, payday loans trap consumers into cycles of debt, and that payday lenders target consumers based on race. Among the claims in favor of the industry are that payday lenders service a segment of society that doesn't have access to credit products offered by mainstream lenders; that there are products just as bad if not worse than payday loans; and that legislatively banning the industry will not only result in the loss of thousands of jobs that payday lenders create resulting in people being forced to rely on even less desirable alternatives.

Interest Rates

One of the first objections against the payday lending industry is the interest rates. In accordance with the Truth In Lending Act, lenders disclose the APR on loans that they offer. Charges on payday loans, calculated as APR, are often in the multiple hundreds of percent. For instance, if a fee rate on a payday loan is $15 per $100 loaned, the annual interest is 391 percent APR. If a person were to have to actually pay 391 percent of the principle, that would certainly be usurious, to say the least. Example: A customer borrowers $100 and contractually has to pay back $391. However, payday loan fees are a one-time cost and do not compound the interest. In fact, many customers default on first pay back and then make payments over time as they can knowing that the lender has little viable recourse options. In this hypothetical example paying back $15 over a six month period would actually only be 30% APR.

Debt Trap

It is also purported that payday loans trap people into a cycle of debt, wherein they have to keep rolling the loan over in perpetuity and pay titanic amounts of money to absolve a debt of a few hundred dollars long after the original loan was paid back. A person takes out a loan, presumably which they cannot repay, and has to roll the loan over again and again, paying more fees and getting deeper and deeper into debt. It has been contended that payday borrowers are more likely to file for bankruptcy than non-payday borrowers.

The notion that most payday borrowers are chronic borrowers does have support. A 2005 study found that many payday borrowers indeed did borrow multiple times over the course of a year, as have many other studies, including those done by the Center for Responsible Lending, and others.**(Flannery, Samolyk 2005)** Lawrence and Elliehausen found that 29.6 percent of payday borrowers surveyed had 14 or more loans in the previous calendar year and 9.9 percent took out 2 or fewer, but 28.1 percent had no renewals or rollovers.

Those aren't the only examples of course; numerous sources cite differing figures. What can definitely be assumed is that a fair number of payday borrowers take out multiple loans every year. However, it must also be assumed as a corollary that not every one of those borrowers is taking out a new loan to pay off an old one. Some are, and it is not inconceivable that it might occur, but that does not necessitate that every person who has taken out multiple payday loans per year is doing so merely for the sake of paying off the previous loan. In fact, the majority of lenders prohibit taking out a new loan until the old one is paid off, and the Best Practices of the industry organizations place a limit on rollovers customers can use. A borrower has to decide for themselves to get another loan.

It's also been claimed that payday loan customers are more likely to file for bankruptcy. One study found that there was a slight correlation between payday customers in Texas and bankruptcy filings, although the number of payday customers who filed for bankruptcy in the study was less than 2 percent of those studied.**(Skiba, Tobacman 2007)** The majority of the Texan payday borrowers in that study filed for bankruptcy due more to debt loads unrelated to their payday debt.

It also bears mentioning that there is a going assumption that anyone can get a payday loan, or that lenders will lend to anyone, in order to get their insidious hooks in them. That isn’t true; lenders have underwriting criteria, though the exact nature or terms of that criteria may differ between lenders. Bear in mind also that most fee income (almost 20 percent in some cases) actually goes towards servicing bad debt. Skiba and Tobacman observed that profits are realized more by established lenders than by newly opened stores. **(Skiba and Tobacman 2007)** Some lenders may reject far more applicants than others. Online lenders reject more applicants (around 98%-99%) than actual stores as there is more risk assumed, and also in order to run an online business, staff with more specialized qualifications are required such information technology specialists, marketing personnel, and so forth.

Predatory Lending

In the wake of the mortgage crisis, there has been great outrage at "predatory lending," a buzzword of the last two decades. According to Adair Morse and others who have studied whether payday lending is predatory, the term was first coined in 1994, and rarely used until at least 2000, and didn't gain prominence in the national lexicon until after 2005. **(Morse)** What "predatory lending" can imply is that consumers are fooled or coerced into agreeing to loans that no one would ever agree to because of the astronomically high interest rates, hidden fees, outrageous terms and require them to hand over their firstborn in case of default or late payment.

The premise is that because people are poor, they become desperate and then a payday lender or cash advance lender offers them a helping hand then charges them several times the amount of the loan in fees. The industry is at times referred to as "legal loan sharking" by critics.

Location, location, location

Another allegation is that payday lenders locate in areas that will put them close to poor people in order to get them to take out loans and then rake in the proceeds from the exorbitant fees that they can never pay off. This assumption attributes the actions of check cashing facilities who market to unbanked individuals to payday lenders as a whole without regard for the fact that large numbers of payday lenders do not offer check cashing and increasingly do not have actual geographical locations.

There are other allegations that payday lenders drive down real estate values and are responsible to urban blight and decay. Urban blight or urban decay is a phenomenon that has usually been associated more with a weakened economy (and many formerly heavy industrial cities began "decaying" well before the arrival of payday lenders, such as Detroit or Baltimore, Md. - the "Rust Belt" was given that moniker before the first payday lender opened their doors), rather than the emergence of a single factor such as payday lending. Given that many of the major recessions over the last century had roots in high finance rather than small volume short term consumer lending, it seems a dubious attribution.

Non competitive spirit

In 2009 testimony before the U.S. House of Representatives, Jean Ann Fox of the Consumers Federation of America asserted that payday lenders, if not put under a vigorous rate cap, will charge the maximum amount allowable. For many lenders, that is certainly true. **(Fox Testimony)** However, these claims do not address that there is a reason why payday lenders have to charge higher fees or rates, and it isn't for exorbitant profit by exploitation of the desperate and marginalized. This would seem to imply payday lenders collude in order to generate the maximum amount of profit they can.

However, legislative caps on fees are price ceilings, which tend to force businesses to come close to the ceiling in order to stay solvent, and the best ways to lower prices effectively is either subsidies to create price floors (as is arguably the case with grain prices) or through free competition in the open market.

The Arguments for Payday Loans

Payday lending plays more of a vital role in modern society today than its predecessors played in the past. Small short term lending is the basic building blocks that all credit systems are built from. There is very little credit risk to borrowers and no chance of losing property or assets upon default in most cases. By making the credit legally available, payday lenders conceivably put greater constraints on actual loan sharks; if there is no need to visit a criminal lender, no one actually would.

A 2010 study found that neighborhoods in which payday lenders were present or had a higher concentration of them, actually had lower rates of property crime. **(Luea 2010.)** There was an increased amount of violent crime, but the increase was negligible - less than 2%. (There is a greater increase in violent crime if a tavern opens in a neighborhood.) Neighborhoods which have payday loan shops that are relatively close by in fact have lower property crime rates than wealthier neighborhoods with no payday lenders present at all.

In areas affected by natural disasters, those where payday loans were available fared better than those where it was not. Fewer foreclosures were recorded, birth rates did not drop, and fewer people had to be treated for drug and alcohol addiction treatment.**(Morse)**

Unfair Interest Rates

While a rate of $15 for every $100 loaned can calculate to 391 percent interest APR, far more than the proposed rate cap of 36 percent, that figure is misleading. If the loan was paid over a year and $15 in interest was compounded every two weeks, then that standard would apply. However, because the loan is repaid within two to four weeks, the fee is not annual interest. If the standard of 36 percent total interest, not applied as APR, were to be applied, then the average rate is actually 15 percent, far less than the proposed 36 percent interest.

Hypothetically, consider the average loan at the average interest rate. The average payday loan is between $300 and $400 dollars, and the average fee charged is between $15 and $20 per $100. Thus, if the median between $300 and $400 is $350, the median between $15 and $20 is $17.50, meaning an average rate of $17.50 per $100 loaned, which works out to a fee of $61.25 on a $350 loan. (Often, payday lenders will assess half the fee on $50 increments, so that's $17.50, 3.5 times over.)

Now, if that $61.25 were to be applied every two weeks, that would work out to 455 percent APR. However, if the interest or fees were to be calculated by the actual amount paid instead of amortized annual interest, then $61.25 in fees on a $350 loan is actually 17.5 percent. That's less than what many people pay on their credit cards, and far less than what can be assessed in overdraft fees. It almost begs the question of why the standard of APR should be applied to payday loans. Annual percentage rate, as a measure of interest paid, applies better to revolving credit or loans with terms of years, rather than weeks or days.

As a hypothetical example, say a person goes into overdraft thanks to a debit card policy which automatically allows the overdraft at the point of sale or the ATM by only $1. We are assuming the customer has agreed to allow overdraft fees on their account so they do not pay a non sufficient funds fee to both the bank and the merchant separately. If that customer incurs a $35 overdraft charge to borrow just $1 which is paid off the next day, that fee works out to 1,277,500 percent interest. A common charge of $35 per overdraft is the fee assessed by Wells Fargo and Bank of America, two of the world's largest banking organizations. How many people in the US have paid an overdraft fee because of a cup of coffee or other small purchase? How many people pay the overdraft within just a day or two? The answer is many and the interest rates charged by banks on overdraft fees are so high it becomes untenable to defend them.

Also, payday lenders have to charge the fees they do to remain in business. It is estimated that anywhere between 20 to 30 percent of payday lenders' income from fees goes towards paying bad debt. It is assumable that the default rate is somewhat close to that amount. One of Jean Ann Fox's comments in Congressional testimony was that payday lenders in Colorado by and large would charge at or near the state's usury cap on payday loans (and therefore lenders were gouging customers because they could and weren't competitive as a business for consumers).

If a payday lender is limited to less than $15 per $100 loaned by statute, they conceivably wouldn't be able to keep their doors open. Furthermore, since rate caps are price ceilings, in order to break even or turn a modest profit, lenders have to come close to if not charge right at the cap. Since price ceilings also have the effect of sometimes driving supply into the black market, it benefits no one, including consumers, to disregard basic economics in the name of what is perceived as altruism. Every loan, no matter how small, has an origination cost. Just because the amount loaned is small does not mean the costs are as well. It was actually found that a lender has to successfully lend and fully collect 6 loans to come up with enough money to lend another. **(Skiba and Tobacman, 2007.)**

One of the recommendations for regulation of the industry is that payday products should become the realm of credit unions and banks or payday lenders should tailor their fee structures to be similar to fees, interest rates, or payment structures on mainstream loans, such as auto loans, mortgages, or personal loans. However, the product may not be profitable for credit unions if payday loans were lowered to more mainstream rates. Lenders would have to charge an origination fee like these other industries which would amount to basically the same costs overall to the consumer.

A study by Victor Stango revealed that not only were credit unions not able to offer lower prices on payday products and break even or profit, they were also hampered by not having hours or locations as convenient as payday lenders. Credit unions often had more stringent requirements (credit ratings, have to be a member, etc). **(Stango)** Essentially, banks and credit unions are not able to compete with payday lenders completely because they aren't able to operate the same as payday lenders. (Some credit unions do offer payday loans, but they are few and far between; according to the same study, it was only 6 percent of National Credit Union Association members surveyed.) Many banks however do have a competing product called direct deposit advance which are only available to account holders with long term history of direct deposit of employment income into that account. Charges for the fees are similar to payday loans but usually slightly lower overall.

Some assume lenders charging such exorbitant fees would lead to outrageous profits. This is not necessarily the case. In fact, the study of FiSCA members that offered payday loans carried out by Ernst and Young (one of the "Big Four" of auditing firms, along with PricewaterhouseCoopers, Deloitte Touche Tohmatsu and KPMG) found that for every $15.26 in fee revenue, only $1.22 was actually realized as profit, which is a profit of less than 10 percent.**(Ernst and Young)**

In a Fordham Law Journal article, it was found that the profit margin among the payday lenders surveyed was less than 8 percent.**(Huckstep)** If a payday lender is restricted to $15 or less per $100 loaned, they would have to offer more profitable services alongside it, as payday lending would be unsustainable as a business. This would mean either that payday services would have to be discontinued altogether, or fees on other services offered at the same location would have to rise accordingly. In response to this many lenders have simply changed their organization licensing and in some cases charters to fall under alternative lending laws that allow origination fees that are even higher as a percentage of the whole loan than previously charged **(Arizona Republic)**.

Other studies of profitability put the profits of the largest of payday lenders (such as Advance America, EZCORP and QC Holdings) at 10 percent. **(Skiba and Tobacman 2007)** A profit of merely 10 percent would certainly not support the surmised stereotype of payday store operators making money hand over fist, as vultures picking clean the bleaching bones of the poor.

Thus, if the Ernst and Young findings are accurate, payday lenders, firstly, face far more risk than traditional lenders, and secondly, have greater costs, and therefore have to charge higher fees in order to remain solvent as a business. In fact, the entire reason for the passage of the Uniform Small Loan Laws of the early 20th century was to legalize and thus make short term lending legitimate in order to accommodate demand and to keep supply safer than relying on less desirable sources for short term credit, such as criminals.**(Elliehausen 2009)**

Targeting consumers

One of the allegations made about payday lending is that lenders will move into specific areas in order to target customers, including allegations that locations are selected along racial lines. The Center for Responsible Lending released a report that says payday lenders in California clustered in areas in which predominantly African Americans and Latinos were located. Again, the actual main focus of these locations where alternative financial services in general like check cashing for the unbanked as well as the general under banked. Robin Prager, in a study released in 2009, found that payday lender concentration correlated better to urban and rural areas where most of the population was younger than 40 and lived above the poverty level. **(Prager 2009)**

Furthermore, the "under banked" are defined as persons who have transaction accounts (checking or savings accounts) but still use alternative financial service providers for financial transactions. According to the FDIC, roughly 17.9 percent or 21 million households in the U.S. are under banked as of 2009.**(FDIC Underbanked 2009)** This means that out of every 100 Americans, 18 of them cannot or do not rely on their banks for all of their financial transaction needs. The FDIC also found that the under banked in America are predominantly African American (estimated at 31.6 percent of the under banked), Native American and Alaskans (estimated 28.9 percent), and Hispanic (estimated 24 percent). Caucasians and Asians made up the lowest percentages of the under banked.

This indicates that a payday borrower or user of alternative financial services is therefore more likely to be black, Latino, Alaskan Native or Native American than to be Asian or white to begin with. In other words, even if payday lenders were deliberately locating in areas where African Americans or Latinos are more heavily concentrated, it may conceivably be due to greater demand for their services there rather than nefarious Iagos and Shylocks colluding, working their turns upon the desperate to extricate their pound of flesh. (Iago schemes and brings about the ruin of the Moor Othello in Shakespeare's *Othello*, and the villain Shylock loans money to the protagonist on the condition that Shylock can extract a pound of his flesh should he default in *The Merchant of Venice*.)

To argue that a business locating where there is demand for their services is predatory simply because of the demographics of the area is patently ridiculous. If that were to be the standard, then marketing to any demographic besides everybody is predatory.

Essentially, claims that lenders are unfairly targeting minorities in this case is like saying that if a chain of retail stores offers parkas rated to 80 degrees below zero in Anchorage while branches of the same retail chain do not in Phoenix is unfairly targeting Alaskans and preying on their need for protection against cold temperatures.

Thus, even if payday lenders were targeting minorities, it would be incredibly difficult to prove they were targeting them for exploitative and racist purposes, rather than going where the greater demand is. A correlation does not always mean a causal relationship. The primary factor here is the other services these establishments offer that cater directly to both the unbanked and under banked populations.

Unfair lending criteria

One of the most common criticisms is that payday lenders do not go far enough to establish the borrower's ability to repay. In order to be considered for a payday loan, customers must prove an income and a checking account, which is far less than it takes to get a mortgage. (Or at least, used to; many people were lent mortgages prior to the events of 2008 on little or no documentation.) The fact that a payday loan borrower must submit proof of an income and financial stability (such as holding a transaction account of some sort) establishes the borrower has the ability to repay, and some lenders, depending on policies, peg the amount of the loan to a borrowers' income, which some states mandate. (For instance, Illinois and Nevada mandate the maximum amount of the loan be a percentage of income.) These are far from being considered "stated" loans as were so common in the mortgage industry, which did not require proof of income.

Lenders also do not check borrowers' FICO scores or report to the main credit bureaus such as TransUnion, Equifax and Experian. Some subscribe to TeleTrack or CL Verify and software programs to check borrowers' industry reports to determine whether they are too great a risk. Furthermore, some states mandate payday lenders maintain and use a statewide lending database to prevent people from taking out too many loans. Being that lenders have little recourse upon default, these rules actually work to protect lenders from borrowers who purposely set out to get multiple loans, knowing they will default. The impression that can easily be gleaned from anti-payday loan interest groups is that lenders approve anyone with a bank account, income and a pulse. However, one study of payday lenders found that about 20 percent of first time applicants were rejected, and 11 percent overall.**(Skiba and Tobacman 2007)** Online payday lenders, as they face greater risks, reject the majority of their applicants altogether.

The view that payday lenders are evil because they do not check credit or report to the credit bureaus is at best misleading criticism. Hard inquiries can dramatically affect a person's credit score and therefore raise interest rates on current credit cards and the costs of future traditional loans. The reason payday lenders exist is that there is a need for short term credit that mainstream financial institutions do not or cannot provide. Payday lenders do not report to credit bureaus because the public demand is for credit outside the first tier of traditional financing options. (Those being the unbanked, the under banked, and those lacking a FICO score ample enough to secure bank approval for credit.)

Predatory Lending

There have been countless accusations, implicit and explicit, that payday lenders are "predatory." Though discussion of what defines "predatory" lending would be to engage in semantic argument, the phrase denotes capitalization upon desperation and either misleading, misinforming or outright omitting the terms of the loan in the first place.

Lenders that belong to FiSCA, CFSA or OLA are required to disclose any and all terms and fees to customers up front and encourage consumers to report violations of the "best practices" and codes of conduct of those organizations. Upfront disclosure must include the rate or fees in both dollar terms and

APR, even though the APR on a short term loan is generally irrelevant. Anyone can walk into a lenders store and see large print APR disclosure signs.

Thanks to many studies conducted, some definite conclusions have been drawn about payday loan demand and payday loan use: The bulk of payday customers make between $25,000 and $50,000 per year, they are more likely to be high school graduates or have completed some college, be married, have children and be younger than 45 years of age.**(Elliehausen 2001)** An overwhelming majority utilizes credit from other sources as well.**(Elliehausen 2009)**

A 2009 study of payday loan demand shows the number of people who borrow from multiple sources of credit is 91.6 percent.**(Elliehausen 2001)** If this statistic is close to accurate (Elliehausen is one of the foremost scholars on the payday industry, though his studies are bankrolled by the CFSA), the average payday loan customer is likely to have multiple debts at once. Payday loan customers are also less likely than average to own their own home, more likely to have an auto loan and less likely to have credit cards. As discussed above, payday lenders are found to concentrate geographically in areas where the population is younger than 40 and is above the poverty line, which seems to confirm the precept that payday lenders locate where demand exists for their services. They are by no means the only business that does so.

Online payday lending demographics are harder to find. Studies do not exist in nearly the same volume for OLA lenders as they do for storefront lenders. However, some websites that function as either loan aggregators or brokers (which find customers a loan from a wide network of lenders or an affiliate of a single lender) do publish their own demographics. Online payday loan customers are, by definition, more literate with computers, and have to just as definitively establish that they either are employed or have a regular income. They also must have valid bank accounts for lenders to deposit the loans in the first place. Online lenders are also more apt to use software such as TeleTrack and CL Verify to confirm that the customer is not an enormous risk.

Part and parcel to the argument that payday loans are predatory is that the fees and terms are not disclosed upfront. Because the policy of the trade organizations of payday lenders and the Truth In Lending Act mandate disclosure of all terms, conditions and fees up front, it does not seem the case that lenders are going out of their way to hide fees or cost structures. (That said, not all lenders are created equal, and not all follow the letter of the law. If that were the case, no lawsuits would ever have been filed against payday lenders, and some have, including class action suits.) Failure to properly disclose FTC APR requirements can end up creating a situation where borrowers can legally get out of paying the fees. Due to the fact that there is little recourse upon default lenders have incentive to mitigate their potential losses by making sure borrowers are fully informed about fees and payment terms.

It was also found, as early as 2001, that a large majority of payday borrowers knew full well what the finance charges were upon accepting the loans.**(Elliehausen 2001)** Of payday customers surveyed in this study, 95.7 percent knew what the finance charges on their loans were and 78 percent remembered receiving disclosure of the APR. Findings of the 2001 Lawrence and Elliehausen study report on only those borrowers who actually completed the follow up interviews. (There were 5,364 people with whom contact for the purposes of study was attempted, of which 2,196 were successful and only 427 agreed to and completed the interview.) The survey was not done in the store, nor was the survey administered by payday loan employees.

Cheaper than the alternatives

The industry claims that its loans are cheaper than overdraft fees, overdraft lines of credit, credit card advances, utility disconnect fees and late fees on bills such as mortgages, rent and credit cards.

As far as overdraft fees are concerned, findings from different sources are varied. Bretton Woods, Inc., the Government Accountability Office and the Federal Deposit Insurance Corporation have all studied banks and credit union overdraft policies and fees. Bretton Woods Inc. and the FDIC both released studies that indicate households pay a high price for overdraft fees and overdraft programs. According to the Bretton Woods study, the average household incurred 12.7 overdraft or non-sufficient funds charges per year, the average OD/NSF fee was $29.58 and the average family paid $376 in OD/NSF fees for 2009. The FDIC found in a study released in 2008 that the median OD fee was $36, but the median bounced check fee was $66.

The same study also found that the most consumer complaints about OD and NSF practices were leveled at the largest banking institutions, and according to the Government Accountability Office, large (for profit) banks charge more in OD/NSF penalties than (not for profit) credit unions do.**(GAO OD fee study)** Though larger institutions hold more in assets and have far greater revenues than the typical credit union, they also are not 503(c) corporations, and thus operate on a for-profit basis and are exposed to greater risk. (Risk affects prices – greater risk means greater scarcity by virtue of greater liability and thus, greater price.)

The manner of overdraft protection or fees also comes into question. Some institutions charge per day an account is overdrawn, and some charge per occurrence of overdraft. A study from 2009 found that 98.4 percent of banks and credit unions charged per occurrence, and less than 1 percent charge per day an account is overdrawn. Since it is assessed as a flat fee, an NSF/OD fee cannot be regarded as credit, even if it is used as such, and therefore is not subject to the kind of regulation that credit cards are subject to. (**Melzer and Morgan, 2009.**) It is estimated that up to 60.4 percent of income for credit unions is from overdraft fee revenues, and upwards of 43 percent of non-interest income and 21 percent of net operating income for banks.

As far as cash advances from lines of credit that are sometimes referred to as direct deposit loans, Wells Fargo and U.S. Bank both charge $2 per $20 loaned in checking advances. That works out to $10 per $100, which is slightly less than what payday lenders charge. Just as with payday lenders, the funds are withdrawn to repay the loan upon the next direct deposit. However, the likelihood that a consumer could put a stop payment on a payment due the bank their account is held at is dubious.

Credit card advances are different. Not only is there a fee (though the exact terms depend on which credit card and through which company) on the withdrawal of cash from the line of credit on the card, the withdrawal plus the fee is added to the revolving balance on the credit card. Most cards have the rule that these credit card cash advances are not reduced until the balance of normal charges is paid in full. This pushes the reduction of the principal toward the end of the credit cycle of the card assuring interest charges may carry on for many years to come. Unlike payday loans, credit cards are not closed end credit, and making minimum payments (the minimum payment can be less than the interest rate regardless of the principal) can conceivably lead to a card carrier making payments indefinitely.

Payroll advances can be secured through employers, or through the payroll company that an employer contracts to perform that function. The military also has this option, but there is a limit on the number of advances personnel can take out. This suggests that some military personnel had been frequenting payday lenders before the passage of the Talent Amendment and had already exhausted this option. After its passage some payday lenders continue to be willing to lend to military personnel within legal boundaries.

Credit availability is beneficial

The effects of any proposed ban on payday lending involve several questions, the most pertinent being whether consumers would be better off without the service available than with it. It depends on how "better" is defined. Fewer bankruptcy filings? Fewer OD/NSF fees or late utility fees incurred? Fewer utility disconnects? Fewer missed payments on credit cards? More reliance on government welfare programs? Would it be a feeling of not being constrained by debt, or would it be further despair over fewer options and knowing that one more option for assistance has been removed?

So far, most studies have pointed to payday lending being a benefit rather than a hindrance. They also show bans do more harm than good. Morgan and Strain found that in Oregon and Georgia, consumers bounced more checks after the payday lending ban than before it.**(Morgan, Strain 2008)** (Methods and results of the study have been criticized by payday loan industry opponents.) Assuming that a ban on payday credit does lead to at least a few more overdrafts or bounced check fees, paying the average payday loan fee of between $62.50 to $70.00 a few times a year would almost be preferable to several bounced check fees, especially because the fee from the bank if often accompanied by a fee from the merchant. Morgan and Strain also found that more filings for Chapter 7 bankruptcy were filed in areas where payday lending was banned.

It also bears mention that bounced checks can be reported to credit bureaus, whereas payday lenders do not look at a traditional credit report and do not report to major credit bureaus. Furthermore, some studies have suggested that people who live in disaster affected areas fare better if they have access to quick credit after natural disasters. The organization that later became Bank of America gained great success by offering quick and easy capital, secured only by a promise to repay after the 1906 earthquake and subsequent fire that ravaged San Francisco (**Morse**).

If the payday industry were to be banned outright, at the federal level, what would take its place? It is obvious that there is a demand for the product, albeit smaller than for other forms of credit (*estimates from various studies suggest that 20 percent or less of Americans use or have used payday lenders, and possibility fewer than 10 percent*) and that the demand is a societal constant given the historical context. It also seems banks or credit unions cannot reasonably offer an alternative. Furthermore, mainline financial institutions exited the short term credit market for a reason and alternatives began taking their place. History has shown there's a propensity for meeting demand regardless of prohibitions.

As discussed above, payday customers often utilize more than one source of credit at a time, or do not have access to other forms of credit. Johnathan Zinman found that 70 percent of the payday borrowers he surveyed either were not aware of or had no alternative to borrowing from a payday lender.**(Zinman 2008)** Also, if people overdraft multiple times because of unforeseen expenses, or not knowing they were going into overdraft, the fees add up quickly. Bank of America charges $35 per occurrence, which used to be more damaging before financial reform reigned some of that in.

Also, car title loans often carry interest rates similar to payday loans, but the ownership of a person's automobile is at stake if the loan goes into default. Pawn loans often have lower interest rates, but people are in danger of losing their property should they default with that as well. Making minimum payments on credit cards (of which the average American has more than one) can lead to a person paying interest on a purchase, even a small one, for decades.

Negative economic impacts of a ban

Whatever one's feelings on payday lending may be, payday lending is a teeming business. Payday loan borrowers take out billions every year. Although the exact number isn't known, there are more than 20,000 locations throughout the United States that have payday loans as part of their product offerings. There are more alternative financial service centers than there are McDonald's or Starbucks. Thus, if the industry were to be banned outright at the federal level, the effects on unemployment rates would be detrimental. Many local lenders are family owned and operated businesses some of which are franchisees. Also, the largest of lenders, those publicly traded (the "Big 7"), have large corporate headquarters with many employees.

According to a study by IHS Global Insights, a consulting firm working on behalf of the CFSA, "payday lending" as an industry in 2007 employed more than 77,000 in-store workers and created more than $10 billion of the GDP of the U.S. Payday lenders paid more than $2.6 billion in taxes (local, state, and federal), and on average, employed at least three people per store. Payday lenders paid $2.9 billion in wages, averaging out to $25,521 per year, per store employee, excluding benefits, which more than 75 percent of payday store employees received from their employers.**(IHS 2009)** A total ban on the industry would be a disaster for an already beleaguered labor market.

Drawbacks of short term credit options

There are possible negative outcomes of the use of any form of consumer credit. For instance, payday lenders can charge high fees for rollovers, if a borrower fails to pay it back and the loan must be rolled over, or a new loan lent to cover the cost of the old one, for an additional fee. Credit card balances accumulate interest in perpetuity, as do lines of credit as these are open ended and have no maturity date. A tax refund loan carries often high fees to use the form of credit, and even larger penalties if the tax refund is rejected by the Internal Revenue Service.

Overdraft protection can also be exorbitant. Overdraft fees can add up very quickly if there are several overdrafts at once. If those are small purchases, it can be very expensive indeed, and not every program allows the consumer the option at either the point of sale or at the ATM. As for actual loan sharks, the dangers speak for themselves.

Car title or pawn loans, unlike other forms of consumer credit, are secured by property. If a borrower defaults, the risk is that they lose the pledged property. A DVD player or video game console may be easy to part with (or at least somewhat), but with car title loans, the collateral used is a persons' car. That means that if people default on car title loans, they may lose their ability to get to work, and thus, conceivably lose their employment and their ability to pay back the car title loan and other expenses, such as utilities, rent, or groceries.

Historical precedents

The history of short term credit is longer than some would think. The kind of consumer credit common today such as credit cards for purchasing consumer goods simply did not exist. Credit extended for reasons other than purchasing an asset or business purposes, or at least for a non-income generating purpose, is a relatively modern phenomenon.

Short term credit was lent against a future payday of sorts, often a harvest or lot of manufactured goods for sale. For instance, a barley farmer would borrow money for seed and repay the lender either with a portion of the harvest, or part of the proceeds of the sale of that seasons' crop plus interest. The Code of Hammurabi, among the earliest law codes, had provisions concerning the lending of money, debt payment, and collection practices. (The Code of Hammurabi was not the earliest law codes, but is one of the most complete from that time period.)

The Twelve Tables of Rome did as well. Funding for a wide range of purposes, including for lending, was secured from people called *faeneratores,* roughly akin to the terms financiers or venture capitalists. (The Roman middle class, in thriving periods, were active investors. Capital for lending purposes is still an investment people make.) The role that payday lenders, alternative financial service providers, and banks fulfill in Roman society were called *argentarii*. They largely dealt with the lower and middle classes, often on the local level. They performed functions such as inspection and exchange of currency, collecting and lending loans, and so forth. They also would make payments on the behalf of a client (as banks and also check cashing businesses do), and even manage the payment of multiple creditors on behalf of a client, as modern debt consolidation companies do.**(Zgur)**

The trade of money lending dates back that far, and interest rates were capped by usury laws. Money lenders are perhaps the longest running precursor to payday lenders, but pawn broking was present in ancient societies as well. The phrase "money lender" carries a stigma, and the villain Shylock from *Merchant of Venice* by Shakespeare, from whence the term "shylock" originated, comes to mind. The negative connotations have secular and religious origins, as lending at interest is prohibited by the Old and New Testament, the Quran, and there were admonishments against lending at too high an interest in secular works. (Adam Smith favored usury caps, and Aristotle believed lending at interest was foolish as money was devoid of the value that actual goods had intrinsically.)

Similar services to payday lending existed before the advent of modern payday lending. In the 19th century, similar businesses lent small, short term, credit against future earnings, which was done by underground private lenders or small loan companies, beginning in large urban and industrial cities (e.g. New York City, Chicago, etc.) along with other antecedents of AFSPs such as check cashing outlets. The borrowers were usually the lower middle class, and would be pay loans back over a few months. Among these small loans were "salary loans," where a portion of future earnings of the borrower would be lent for a finance charge, or "chattel mortgages", which were lent against property the borrower held. As these loans could not be made under the usury caps of most states, they were unregulated and illegal.

By the dawn of the 20th century, social reformers were outraged by some of the practices of these lenders, but they were cognizant the demand was immutable. In contrast with payday lenders, who often charge less than 500 percent APR (applying the standard of APR to a loan lasting a month or less), the form of credit of "salary buying" often charged 1000 percent interest for their loans.**(Zwyicki 2009)** This led to states passing Uniform Small Loan Laws, which raised the ceiling on how much interest lenders could charge, as the previous usury law made such loans unprofitable.**(Elliehausen 2001)**

The first actual payday loan store, per se, is difficult to nail down. However, it is safe to assume that in 1980, the industry didn't exist. Among the first were First Cash Financial which was launched in 1988, check cashing firm QC Holdings started offering payday loans by 1992, and Check Into Cash was opened by W. Allan Jones in 1993.**(Huckstep)** Since then, the industry has grown to more than 20,000 stores nationwide by 2004, with loan volume somewhere around $40 billion by 2003.**(Flannery, Samolyk 2005)** The primary source of these transactions is the traditional brick-and-mortar payday loan store, though many lenders have online operations as well. Many payday loan stores also perform check cashing services, and vice versa.

Essentially, there has always been a demand, and a supply, for short term credit. There obviously is no known first instance of one person lending money to another in order to overcome a sudden shortfall. What is definitely known is that there always has been and will be a need for a financial bridge between a shortfall today and an upcoming payday of some sort. The lingo of the payday industry, such as “payday loans,” “cash advance” or “short term loan" is merely contemporary terminology for an ancient service and practice.

Thus, it would stand to reason that attempting to rid society of the supply without addressing the demand would be foolish. Consider the events of Prohibition in the early 20th Century; people will turn to less desirable alternatives to satisfy their demand. The number of people who suffered grave health effects as a result of improperly prepared homemade liquor or using dangerous substances to satiate their thirst for alcohol (for instance, Jamaica Ginger tonic contained dangerous neurotoxins and others drank hair spray) is a testament to that. The amount of money made by organized crime during the period is also proof positive people will find a way to satisfy a demand.

There is also the unbanked and the under banked to consider. Check cashing businesses have been around for decades. This would indicate that some segment of society does not maintain or have access to either a bank or credit union and their services, like transaction accounts or lines of credit. Others have these resources but do not have the credit rating to have a line of credit or a credit card. Some simply choose to use alternative financial services.

An FDIC study reported 9.9 million or 7.7 percent of the U.S. population was unbanked, meaning they held neither a checking nor savings account.**(FDIC Underbanked 2009)** The same study also reported 21 million people or 17.9 percent of the U.S. population is under banked or had a bank account but still used alternative financial services. The unbanked would have no access to payday lending, as a customer needs to have a checking account in order to secure the loan. However, the under banked would. As there will likely always be people who go under banked, there will always be a demand for alternative services.

As credit, especially short term credit, became the province of banks with lines of credit and credit cards, the non-bank market for short term credit dried up for consumers without the credit rating for access to mainstream banking. Thus, by the 1990s, market conditions gave birth to payday lenders. In light of both unavailability of bank credit for portions of society or their choice to simply not use it and the historical context, there is little reason to assume that the payday lending industry has been driven by anything other than a demand, and that it is unlikely to dissipate. As consumer debt loads have increased, through multiple credit cards, multiple cars per family and greater amounts of student debt, it becomes harder to eke out a living, and assistance is sometimes required beyond what is conventionally available.

Exact, or rather more comprehensive statistics and numbers for the industry as a whole are difficult to find out. The bulk of data is extricated from industry trade organizations such as the Community Financial Services Association of America or from consumer advocacy groups that are dead set against the industry. The CFSA, as well as the Financial Service Centers of America, regularly publish research done independently, as do consumer advocacy groups.

As of 2007, there were at least 22,000 payday loan stores operating nationwide.**(Elliehausen 2009)** Legislative proposals are being put to state and federal legislatures to further reign in the industry, although the various trade organizations of the alternative financial services (AFS) industry are making considerable efforts to self-police, including online lenders, who are the most difficult to obtain data on. Though a trade group exists for online loan lenders, the Online Lenders Alliance, it is unknown how many actual online payday loan lenders exist, or how much in business they actually do. The future of payday lending remains to be seen.

Conclusions

Conclusions from academic studies concerning payday lenders are first that the advanced level of study on this tier of the financial system is just beginning to compile, given that the industry is in its relative infancy. Second, many definitive conclusions are hard to derive about the relative "good" or "bad" nature of payday lending as an industry, the reason for which is that many of the reports about it either assume that it is ultimately good or bad outright and do not address both pros and cons.

Demographic studies should be viewed with a somewhat skeptical eye – if a person surveys payday customers in areas where there are heavier concentrations of Latinos and African Americans, it could be more likely to conclude payday lenders are targeting them. Does this mean that payday lenders are targeting these minorities? Not necessarily, and it would be hard to prove if they were. If that were true, there would be no payday lenders in areas more predominantly populated by Caucasians at the same income level as the Latino and African Americans that it is claimed they target. That isn't the case.

What actually defines "predatory" lending? That term, among others like "judicial activism," can be manipulated to mean whatever someone wants it to mean. It could be easily surmised that a major bank executive believes that a loan made to anyone by any party other than the bank that he or she works at is predatory, simply because it was lent by someone else or by a lending organization he or she finds distasteful for whatever reason. Does a mortgage loan that's not lent by a major bank or credit union count as a "predatory" loan simply because it doesn't come from a more traditional source? Is there much, if any, objective prospective that can be drawn from the scant data that exists about traditional and online payday lenders?

There are indeed some definite conclusions that can be reached. It is certain that there has always been a demand for the services that payday lenders provide. Not only is there a long historical basis for financial services outside the mainstream (for instance, pawn broking) there is also a long history of services similar to payday lenders. Payday lenders in and of themselves are simply a new name and form of an older tradition, for instance "salary buyers" of the late 19th and early 20th century. The usury cap was raised for a reason by the Uniform Small Loan Law, so that the demand could be met legally and therefore more safely than an underground industry that authorities had to turn a blind eye to.

At least some segment of society needs financial services not delivered by banks or credit unions; otherwise there would not be unbanked or under banked people. Some consumers do not have the credit rating to secure traditional financing, and they have an immediate need that payday lenders can meet, through not only more convenient locations but also more convenient hours of operation. (Payday lenders are often open for business when and where banks are not.)

The reason behind the existence of payday lenders is that they offer a small, short term credit product that mainstream financial institutions do not. They also do not require membership. A payday loan can also be secured without submitting to a credit check, and takes minutes, rather than hours or days. A payday loan also does not require collateral, whereas a car title loan or pawn loan does. Payday loans are more convenient than securing a line of credit through a traditional institution. The relative ease of access and the lack of need for collateral in addition to the absence of a credit check or reporting to the credit bureau are in fact the primary appeals and functions of the product. The idea is to provide credit to people who can't get credit, and also not have it affect their credit.

The cry for payday lenders to check credit reports is counterproductive. Payday customers may be (going by statistics) more likely to have exhausted their other lines of credit, aren't deemed creditworthy by mainstream financial institutions or do not want to submit to more inquiries on their credit reports. If payday lenders were to pull an applicants' FICO scores, those scores would take a hit merely because someone requested to view their credit report. Why then, would someone advocate for a business to suddenly start practicing the very same rules that they came into existence to circumvent for those who couldn't get through that barrier? If payday lenders were to start doing so, they would actually hurt the consumers they aim to serve.

Payday loans come with higher costs, in a sense, than some other forms of consumer credit. However, the APR is deceptive in that it applies the same standard as a mortgage that matures over decades to a small loan that matures over weeks. The application of the APR standard to a two week loan is unfair. Also, the loans must be higher cost because there is greater risk and less insurance against default. Furthermore, lenders have little recourse in recovering funds.

A customer can easily get around paying back an online lender by closing their bank accounts. Because the average loan is only for a few hundred dollars, storefront payday lenders may end up losing more than they could possibly recover after a few billable hours by an attorney, court costs and retainers. Borrowers also can put a stop payment on a check if they believe it will bounce, and a lender can't try to collect it if a stop payment is put on the check.

Banks and credit unions have not yet provided a better, lower cost alternative, or at least they haven't on any sort of appreciable scale. Fewer than 6 percent of credit unions (of the NCUA institutions surveyed by the Stango study) offer any sort of short term, small dollar alternative to a payday loan. If short term, small dollar, unsecured credit products were viable for banks or credit unions, they would have offered the product decades ago. A viable alternative that fills the same niche and performs the same function has yet to materialize.

Some of the "alternatives" to payday loans are less than palatable. Pawn loans and car title loans can result in loss of property. Overdraft or non-sufficient fund fees can add up to more in interest, and also in actual dollars depending on the exact policy of the bank or credit union in question. Checking or line of credit advances can amount to almost the same thing as a payday loan, and credit cards can be an even greater debt trap than any payday loan, as they are open ended, and minimum payments never touch the principle. Then there is the criminal underworld, who are precisely who would be put out of business if consumers have access to the short term credit they need legally.

Payday lenders and alternative financial service providers obviously desire to stay in business and to operate within ethical guidelines of doing business, or at least most of them do. The CFSA has been around since 1999, the FiSCA since 1989 and the OLA since 2006, and all of these trade organizations require member organizations to conduct themselves ethically and legally, to disclose any and all fees and terms fully. They even encourage consumers to report an offending member organization in case of a breach of these protocols. They haven't argued for complete deregulation and, in fact, have come out in favor of some legislative reforms. Still, for payday lenders to be able to project a positive image in any way is difficult with the amount of negative media coverage they have received over the years.

There's no evidence that payday lending is a cause of poverty, proximate or otherwise. There is evidence that there are benefits to payday lenders' presence (lower instances of overdraft and bounced checks, and access to credit that traditional lenders will not extend), and one has to bear in mind that there was abysmal, wretched poverty in the world, including the United States, long before payday lenders arrived, and even before the modern system of banking did.

Obstacles in the way of the average "Joe" or "Jane" creating real wealth are also a greater cause of poverty than payday lending ever could be. Manufacturing jobs, long the backbone of the middle class, were leaving America far before the first modern payday lenders opened their doors, and the precedents of payday lenders weren't the proximate cause of poverty in their time either. Obstacles to gainful employment are the most detrimental on Americans' financial stability. Furthermore, one has to not only be employed, but have a bank account in order to even get approved for a payday loan.

There are other factors to consider, such as the rising costs of goods and services such as medical care or the college tuition. The number of credit cards the average American holds should also be mentioned – and many payday loan borrowers utilize payday credit because their other avenues and options are closed to them due to credit history or lack thereof. There is some statistical evidence to suggest that unexpected expenses are one of the most common reasons why people borrow from payday lenders; this implies that at least some payday borrowers do not have enough disposable income to cover an emergency expense such as a flat tire or a broken water heater.

Consider also that economist Arthur B. Kennickell found that by 2004, the richest 10 percent of the nation held almost 70 percent of the wealth.**(Kennickell, 2005)** This is not to say, obviously, that a radical redistribution of wealth is warranted, proper or necessary -- far from it. However, with that being said, any obstacles in the way of working people generating wealth within their communities are a far greater burden than payday lender.

Also consider the nature of the debts people are encouraged to take on. Mortgages are meant to not be paid off before the maturity date (as evidenced by pre-payment penalties), and credit card companies love for a person to make only the minimum payments. In fact, if a person pays off and closes a credit card, or in other words pays off a debt, that is a negative mark on a credit report. Debt is encouraged by mainstream finance; payday loans, by their very nature, are meant to be paid off as soon as possible, as outstanding debts are liabilities for payday lenders. Furthermore, think for a moment about the relative "institutional" status of these mainstream debts. A person can be locked into a debt for decades, yet it is seen as "good debt."

Of course, payday loans are not without their downsides. Lawrence and Elliehausen's surveys of payday lending demand found that payday consumers, though mostly aware of the product they were using, did favor some sort of governmental oversight -- especially with regard to how much credit could be accessed per year -- and weren't happy with the amount they had to pay to use payday credit. Just more than half of the industry belongs to the three main payday lending trade groups. So while a majority of the overall industry follows the Best Practices outlined by those groups, nearly half do not necessarily. Furthermore, even within companies that do mandate Best Practices, not every member location is in full compliance with those guidelines. Consumers would do well to educate themselves about businesses they are considering borrowing from, and to consult the Better Business Bureau regarding the lender to find out whether the company is a member of one of the trade organizations.

Payday lenders, including the largest and publicly traded lenders, have been sued in nearly every state. (The "Big 7" have all been sued because of lending and collection practices, and so have a large number of smaller lending firms.) This includes class action suits. Keep in mind, one would be hard pressed to find any large corporation that hasn't been sued at one point or another, though the fact that large corporations sometimes get lawsuits filed against them would hardly exculpate any corporation from having wronged anyone legally or otherwise.

The debt trap, one of the most cited arguments for restricting the amount and/or number of times one can borrow is certainly a possible outcome if someone is a serial borrower. That being said, it isn't known from the studies done whether a person who repeatedly borrows is doing so because they are in that situation. It is a possibility, and a risk, but there are risks involved in using any kind of credit. Credit cards can trap a person only able to make minimum payments for decades, as can other large loans, such as mortgages, auto loans or student loans.

Think of the college graduate who takes on tens or hundreds of thousands of dollars of debt, only to get out into the world to find their degree useless or the market saturated with others with the same degree. Think of home buyers whose equity is lost to market fluctuations devaluing the home they have struggled to purchase. Consider auto loans; while a new automobile may offer the security of a car that won't mechanically fail, it loses up to a third of its value once driven off the lot. Also, auto dealerships undervalue trade-in vehicles and try to lock consumers into the highest finance rate on loans for the cars, without telling the potential borrower what else may be available from other lenders.

Payday loans are not a cabal of back alley usurers conspiring to rob the poor of what little they have once the need for a small sum of money arises. Payday lending is a business, to be sure, but is not the profit mill some assume it is. Payday lenders assume a hefty amount of risk with far less recourse if a customer defaults than a traditional lender has. The borrowers are often middle class (making $24,000 or more), and likely hold a high school education or greater. Estimates of the total portion of society that actually uses payday lending range from less than 10 percent to 20 percent of the total U.S. population. Considering all the other problems that face modern society, is payday lending really, for one, actually a priority for legislation, and for two, really even an issue?

Short Term Credit Product Definitions

Payday loans

As the name implies, a payday loan is a loan made against the customers' next payday. The typical method of securing one is for customers to enter a payday loan store, where they furnish proof of identity and sometimes are asked to provide their most recent bank statement. Then they are asked to either furnish a check dated after their next payday, for the loan amount plus a finance charge. On that date, the post dated check is cashed by the payday lender. The average payday loan amount, according to a 2009 study of FiSCA lenders (Financial Services Center of America) by Ernst and Young, was $379. The average rate charged was from $15 to $20 per $100. **(Ernst and Young)**

The number of studies reporting figures of $15 to $20 for every $100 loaned is legion. Thus the figure can be taken as granted, and for proof one can look at Lawrence and Elliehausen 2001, Elliehausen 2009, Flannery and Samolyk 2005, among many others. However, this figure is representative of traditional brick-and-mortar payday lending stores, as there is scant data for online payday loan lenders. Online payday lenders are assumed to charge more; closer to $30 or more per $100 loaned.

Credit Cards

Credit cards are lines of credit that are utilized via a card with a magnetic reader strip. Typically, credit cards are only used at the point of sale, and they carry a limit determined by an applicants' credit rating. Credit cards can be prime, subprime, secured by an upfront deposit or unsecured. The interest on credit cards is usually higher than on traditional lines of credit (up to 20 percent or more), balances are revolving (meaning the balance has no maturity date and payments can be made solely on the interest in perpetuity without touching the principle), and interest is only assessed on the funds used, though the nature of how that interest is assessed depends on the brand of card being issued (VISA, MasterCard, Discover or American Express) and the institution offering it.

Short term credit offered by banks or credit unions

It has never been the case that banks or credit unions offer no short term credit options, but it is the case that these products can be beyond the means of consumers with a low or nonexistent credit rating. It is also the case by definition that those consumers who are unbanked (having no transaction accounts of any kind) do not have access to them at all. Some banks and credit unions offer lines of credit, overdraft loans, cash advances on credit cards, and some offer payday loans. Myriad financial products for shorter periods of time than an automotive loan or mortgage loan exist. Most of the conventional products differ by name, but fit only a few descriptions by action. The major difference between consumer credit products offered by banks and credit unions and those offered by check cashers and payday lenders, is that in order to have access to these services, one has to be a member or customer of the bank or credit union in question. **(NCLC payday alternatives.)**

As mentioned above, less than 10 percent of the nation has no bank account of any kind, and less than 20 percent still have a need for financial services elsewhere. Perhaps it's because some employers still do not use direct deposit, people cannot get to a bank before it closes or perhaps they lack a credit rating that would allow them access to these services. These products and services can roughly, by definition, fit into a few categories: advances on checking -- or credit or cash advances -- lines of credit, credit cards, personal loans and overdraft prevention products. Each has its relative merits, and as with any product, they also have some drawbacks.

Cash advances

An advance simply means that a sum of money is advanced on an upcoming payment, or an amount of cash withdrawn from a line of credit. An interest rate and/or fee are assessed on the sum, and then the sum plus interest or fees are repaid on either the due date or over several installments. An advance can take several different forms, such as an advance line of credit offered based upon the income of the account holders or their credit rating and history or both.

The Wells Fargo Direct Deposit Advance and U.S. Bank Account Advance programs, for instance, charge $2 per $20 loaned, on a line of credit the bank determines based upon the average monthly income of the account holder, and the whole amount of cash advanced plus the fees are either repaid by borrowers on their next payday or automatically withdrawn from the account upon receipt of the next deposit. (Not dissimilar at all to a payday loan.) Advances can also be drawn from credit cards. There may be additional charges for using the line of credit on a credit card to withdraw cash, such a transaction fee.

The exact structure of a cash advance depends on the institutions, how or if they offer the service, and their own criteria for using the service. An advance on pay, secured by promise of a future payment, also well fits the description of a payday loan, and in some cases, the interest rate and fees on one from a bank are barely competitive with payday lenders.

Lines of credit

A line of credit is an amount of money that a bank or credit union is willing to extend to a customer, based on account history, average income and/or credit history. Portions of the line can be transferred into checking, with a revolving balance, similar to a credit card. Interest is only assessed on the money withdrawn. A line of credit may be either secured (meaning backed by collateral, e.g. a home equity line of credit against the equity a homeowner has in their home, or HELOC) or unsecured (not backed by a security). They often carry lower interest than credit cards, and are determined usually by credit rating, but practices and protocols vary from institution to institution.

Overdraft protection products

Nearly every banking institution offers some form of overdraft protection, in case a customer spends more money than actually have. These programs will cover the balance of the overdraft, for a fee. There is a cornucopia of overdraft products from financial institutions that consumers can utilize, and it is a huge source of revenue for banks and credit unions. A 2008 FDIC study of overdraft protection programs and practices identified four distinct types of overdraft protection **(FDIC Overdraft study)**:

Automated overdraft programs

This type of overdraft protection program is where an automated system adjudicates whether to cover an overdraft. The nature of these programs varies by institution, as members of the bank or credit union may be made aware of the existence of the program or not.

Linked transfer accounts

These programs link all accounts of the customer together in case of an overdraft. If a checking transaction draws more than customers have in their checking accounts, the bank automatically draws from their savings account, line of credit or credit card to cover the remainder, and assesses a fee for doing so.

Overdraft lines of credit

In this type of overdraft program, a line of credit is established in case of an overdraft. The opening of an overdraft line of credit is first dependent on the customers' credit rating and history. The bank or credit union agrees to extend a line of credit over a certain period of time to cover overdrafts only, separate and distinct from any other line of credit that customer may already have with the institution. It is treated as a loan, and interest is assessed on the funds lent.

Ad hoc

Essentially, this is an overdraft protection product or service that doesn't fit the above three descriptions, according to the FDIC study. There may be informal practices at any individual institutions regarding overdrafted accounts that are dealt with on a case by case basis. There may also be a third party that the bank or credit union puts in charge of their overdrafts and overdraft services.

Comments

Overdraft protection programs bear mention as a source of short term consumer credit, as consumers can at times overdraft an account knowingly and simply pay the balance along with fees upon their next pay date, or whenever they are able to do so. There are differing structures of overdraft fees offered by banks, and not every bank or credit union assesses overdraft fees or bounced check fees exactly the same way.

Also, not every bank or credit union takes the same action regarding overdrafts, especially regarding the use of debit cards. Some institutions will automatically honor the transaction, and then tack on an overdraft fee. Other institutions will deny transactions at the point of sale (POS) or at the point of withdrawal (such as at an ATM) and simply not allow overdrafts. An FDIC study on overdraft fees from 2008 revealed that a large majority of banking institutions (81 percent or more) allowed overdrafts at either the POS or ATM, thereby guaranteeing that an overdraft fee of some sort would be assessed.

A study published by Bretton Woods Inc. in 2010 reported that the average household with an active checking account incurred 12.7 overdraft fees (OD) or non-sufficient fund fees (NSF) in 2009, which marked an increase from the 11.8 NSF/OD fees in 2008. The average NSF/OD fee, from the same study, was $29.58 in 2009, meaning that at 2009 rates, the average household with an active checking account pays $375.67 or more in OD/NSF fees annually.**(Flores. Bretton Woods Study.)** As overdraft fees can harm a person's credit rating and banking history, and payday loans do not, this seems to further emphasize the relative utility of a payday loan in warding off potential harm to one's credit score.

Personal loans

Personal loans are loans made, either with or without a security such as a home or car offered as collateral, for any and all purposes. Unsecured loans typically carry higher interest rates than conventional loans, such as an auto loan or mortgage, and are for much shorter periods. For instance, an unsecured personal loan through the peer to peer lending service Prosper can carry an interest rate as high as 7.5 percent and a term of 3 years or less, which that service advertises.**(Propser.com ads)** Banks or credit unions lend personal loans and so do finance companies, and the amount of the loan and approval for the loan depends on the potential borrowers' credit score, employment history, and so forth. A personal loan can be made by a bank, credit union or finance company, for any amount or length of time, secured or unsecured.

Other forms of short term credit

There are other forms of short term credit available aside from payday lenders and conventional lenders. These are just a few.

Pawn shop loans

Pawn shops have existed for thousands of years in some form or another. The premise is simple enough – a customer enters a store with a piece of property. The pawn broker will offer a loan based on the value of the property. The loan, plus interest, is backed by the security of the property, and the borrower must return to the pawn broker within a set amount of time and pay the loan and interest in full in order to retrieve said property. If the borrower is unable to, the pawn broker will try to sell the item to recoup the loan.

Car title loans

There are also car title loans, wherein a person will take out a line of credit secured against the title to their car. These are especially risky, as customers run the risk of their cars being taken possession of if they are unable to pay the loan off.

Tax refund loans

Another option, at least around tax season, is the Refund Anticipation Loan. Refund Anticipation Loans, or RALs, are a loan against a prospective income tax return check. Similar to a payday loan, the product is a loan against an upcoming check. They are often lent to borrowers by tax preparers; one of the largest sources of RALs is H&R Block. Borrowers can get a portion of their anticipated refunds prior to acceptance of the return by the IRS, and when it comes time to pay back the loan, borrowers must also pay a fee. The hitch, of course, is that if the return is not accepted by the Internal Revenue Service, the borrower still has to repay the entire loan plus interest and/or fees. The interest charged can be quite high, and RALs and lenders are often targets of consumer advocate groups. They've also become targets of State Attorneys General. The Internal Revenue Service does not officially endorse or condemn the practice, but urges consumers to wait instead of resorting to the option, as electronic filing can get their refunds in one to three weeks in some cases.

Illegal loan sharking

There is also the illegal money lending trade. There are actual "loan sharks," but because this type of lending is illegal, it is unknown how many people actually resort to this option. A lender will loan someone a sum of money, and borrowers must repay it, with interest, or face retribution in the form of harm to their person, to their families or to their property. Because this "industry" is an illegal trade, often carried out by members of organized crime, there is (obviously) no regulation, and little, if any, reporting or data available. In comparison with any other form of lending, be it prime or subprime, this is easily the worst option. A few extra dollars in interest from a regulated and legal lender is far easier to live with, and any known loan sharks should be reported to the authorities.

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