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Research Findings Illustrate the High Risk of High-Cost Short-Term Loans for Consumers

Payday Loans

Payday loan borrowers are worse off than consumers who have no access to payday loans. Colby College researchers simulated families trying to pay bills in spite of budgetary constraints over a 30 month period. "Borrowers" who used the typical volume of payday loans per customer per year for this industry were found to be worse off financially than those without access to payday loans.[1]

Using payday loans causes financial hardship for families. A University of Chicago Business School doctoral student compared households in states with and without access to payday loans over a five year period and found that access to payday loans increases the chances a family will face hardship, have difficulty paying bills, and have to delay medical care, dental care, and prescription drug purchases.[2] These finding are bolstered by findings in the Detroit Area Study (DAS), conducted by a University of Michigan law professor. Comparing payday loan users with similar low to moderate-income households in Detroit who did not use payday loans, the DAS found almost three times the rate of bankruptcy, double the rate of evictions and phone cut-off, and almost three times the rate of having utilities shut off.[3]

Using payday loans increases the chance of losing a bank account. Harvard Business School researchers examined involuntary bank account closures in states where payday loans are available and states where these loans are prohibited to determine the impact of loan availability on account closure. Advocates argue that using payday loans leads consumers to overdraw accounts while lenders claim that the ability to get payday loans saves consumers from otherwise overdrawing their accounts. The study found that an increase in the number of payday loan outlets in a county is associated with an eleven % increase in involuntary bank account closures, even when other variables such as income and poverty rate are taken into account. To test the theory, researchers looked at Georgia, a state that bans payday loans but is surrounded by states that permit the product. Counties at least 60 miles from the border with payday loan states had a 15.6% decline in account closures when Georgia expelled payday lending.[4]

Payday loan users who also have credit cards are twice as likely to become delinquent on the card. Researchers at the Chicago Federal Reserve Bank, Vanderbilt University, and the University of Pennsylvania examined a large sample of payday loan users who also had a credit card from a major issuer. They found that taking out a payday loan makes a borrower almost twice as likely as other credit card customers to become seriously delinquent on their credit card during the next year. For all credit card users, the seriously delinquent rate is 6% while for payday loan borrowers in this sample, the rate is around 11%.[5]

Payday loans have a fifty-fifty chance of causing defaults in the first year of use. Researchers at Vanderbilt and the University of Pennsylvania examined a large sample of payday loan files at a Texas payday lender and found that over half (54%) of borrowers defaulted on loans during the first year. By the time loans are written off by the lender, borrowers have repaid fees equaling about 90% of their initial loan principal but are counted as defaults for the full amount of the loan.[6]

Using payday loans causes borrowers to file for bankruptcy. In a large Texas study, researchers found that borrowers who got payday loans were about twice as likely to file for bankruptcy in the next two years as payday loan applicants who were turned down for payday loans. And, the bankruptcy impact was strongest on women, blacks and homeowners.[7] And when they filed for bankruptcy, their payday loans accounted for about 11% of their total annual interest burden.

<u>**Other High Cost Small Loan Products**</u>

Car title lending risks repossession of major family asset. Car title loans are typically single payment loans secured by title to the family vehicle owned free and clear. Over half of these loans are for $500 or less and typically cost 300% APR. Failure to repay can result in repossession. The Tennessee Department of Financial Institutions reports that over eighteen thousand vehicles were repossessed in 2006.[8] The Virginia attorney general settled a complaint against one title lender who had repossessed 12,000 cars in less than two years.[9] According to Virginia Department of Motor Vehicle data, title lenders obtained 6,524 repossession titles needed to sell cars lost by borrowers in 2008.[10]

Refund anticipation loans drain about $900 million in loan fees from 8.67 million taxpayers in 2007. Bank loans secured by taxpayers' anticipated tax refunds cost 50 to over 500% effective APR and are repaid in less than two weeks by deposit of tax refunds from the IRS.[11] Nearly two-thirds of RAL borrowers are the working poor (but just 17% of taxpayers) who receive the Earned Income Tax Credit, the largest federal anti-poverty program which is distributed through the tax system. RALs drained over $600 million in loan fees from the EITC program in 2006.[12] These are risky loans, as well. If the tax refund or credits are denied or reduced, the RAL borrower still owes the bank for the loan and may face late fees, debt collection harassment, and a damaged credit history.

Compiled by Jean Ann Fox, Consumer Federation of America
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