STOP THE DEBT TRAP

Instead of Predatory Loans, a Variety of Strategies Can Help People to Address Budget Shortfalls

The Veterans and Consumers Fair Credit Act will cap interest on personal loans at 36%. Predatory, high-interest loans do not help people, they only put people deeper in debt and make problems worse. There are no easy answers to not having enough money, but consumers can and already do make use of a wide range of safer and more affordable options when times are tough. Many options do not involve taking on more debt. There are more options for people who face a one-time emergency than for those who chronically do not have enough money to meet their expenses, but high-cost debt is not the answer for either group.

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1. Lower-Cost Loans:

Affordable, safe credit options are available to many consumers facing cash shortfalls. If faced with a budget shortfall and payday loans were unavailable, many payday loan borrowers said they would look to a bank, credit union, credit card, or employer for a loan. However, more credit (and debit) is not always the answer for consumers, so those without the ability to repay even low-cost credit should look to noncredit options. Those facing a one-time emergency will have more credit options than those who regularly have expenses that exceed their income.

- **Affordable, small-dollar loans offered through a bank.** Since a bank account is required for most payday loans, consumers should look to the bank where they have accounts. Many banks offer their customers access to emergency loans or other small-dollar loans at rates below 36%.
- **Low-cost CDFI loans or federal credit union loans.** Many Community Development Financial Institutions (CDFIs) offer low-cost loans. In addition, many federal credit unions offer Payday Alternative Loans (PALs) which, at an interest rate of 28% plus an application fee, are relatively inexpensive. Other credit unions, state and federal, offer small dollar loans at 18% or less. These loans are much safer products that are widely available to borrowers who join a credit union.
- **Traditional credit cards**. Some payday loan borrowers have available credit but mistakenly view a payday loan as a safer option than adding to credit card debt. However, the interest rate for credit cards is a fraction of the interest of a high-cost loan, and credit card borrowers who are not carrying a revolving monthly balance are entitled to a no-cost grace period each month. Further, consumers may be eligible for a credit card advance. Although advances carry advance fees and higher interest rates than purchases, they are cheaper than payday loans and can be repaid in installments.
- **Subprime credit cards.** Even credit cards aimed at subprime borrowers have interest rates that are far lower than a high-cost loan. Many banks and credit unions offer credit cards especially designed to work for subprime borrowers with blemished credit histories.
- **A loan against retirement savings.** Some retirement savings plans allow people to borrow their own money, paying the interest to themselves rather than a lender. But people should avoid early withdrawals of savings that will be needed for retirement.
- **Other online loan options.** Some online lenders offer affordable installment loans. While not all products are created equal, certain mainstream lenders adhere to responsible lending standards, including interest at or below 36% APR and a focus on ability to repay.

2. Prioritize Essential Expenses:

When surveyed about facing a financial emergency, former payday borrowers have most commonly said they would cut back on expenses when faced with a financial shortfall. There are many ways to lower expenses or manage existing debts, and many non-profit organizations offer credit counseling, financial coaching, and other resources.

- **Many consumers contact mortgage servicers, auto lenders, student loan servicers, utility companies, credit card companies and other creditors and request forbearances.** In some cases, loan servicers have the authority to negotiate forbearance or deferment agreements that are cheaper than high cost credit. Many landlords, merchants, and utilities will also work with struggling borrowers to accommodate delayed repayment for free or at lower prices than predatory lenders. Creditors and merchants will often negotiate new repayment plans, income driven repayment plans, deferments, and forbearance options. It is best to make a request before missing a payment when possible.
- **Consumers negotiate payment plans or use existing charitable care options for medical bills.** Nonprofit hospitals are required to offer free or low-cost care to eligible patients. For other medical bills, consumers can request a payment plan from collection agencies and medical providers/billers. Consumers can also try to negotiate a lower price with hospitals or other health care providers. If accounts are already in a payment plan, sometimes the terms can be adjusted if the consumer can't meet the original obligations of the plan
- **Automatic, recurring payments can be canceled.** Many subscriptions and services utilize recurring payments that are deducted automatically each month. Consumers may even have been enrolled in a membership plan without knowledge, so it's helpful to review credit card and bank account statements every month. Canceling unnecessary or unused subscriptions can easily lower expenses. Consumers have the right to stop automatic recurring payments to lenders, though they will still owe the debt and may face collection activity.
- **Debt collectors will negotiate or can be ignored**. Low-income people may be "judgment proof" -- have income so low that collectors are not able to take anything. Old debts may be beyond the legal limit for a lawsuit or for reporting on a consumer's credit report. Debt collectors also are commonly willing to make significant cuts to debts in exchange for payments and to work out payment plans.
- **Credit counselors or financial coaches can help identify ways to manage expenses and identify resources**.
- **State laws protect bank accounts, wages, and other assets**. Debt collectors and creditors often collect legal judgments by seizing bank accounts, wages, and sometimes cars or other property. But in every state, there are laws that protect a certain amount of assets, though the laws vary state by state. If faced with an attempt to collect a judgment, a consumer should seek legal advice or ask the court clerk if they have forms to fill out to protect wages and assets.
- **Bankruptcy may be an option**. Bankruptcy may seem like a drastic step, but it can be a lifeline for getting a fresh start. A high-cost loan may simply drive a consumer into bankruptcy later on and put off the date when their good standing will be restored.

3. Additional income sources:

Former payday borrowers also reported building savings and incomes to cope with financial challenges. There are many safe options to build income and savings that do not involve taking on more credit, including through employer benefits, public benefits, and charitable organizations and churches.

- **Employer benefits.** A growing number of employers offer emergency savings programs, affordable small dollar loans, free early access to earned wages, and other assistance programs. But fee-based early wage access is often another form of payday loan.
- **Other options for extra income, including extra shifts or additional forms of employment**. A poll of former payday loan borrowers shows that building income is one of several methods used to meet financial emergencies in the absence of payday loans.
- **Public benefits.** A variety of federal, state and local programs may provide public benefits, such as Temporary Assistance for Needy Families, SNAP (food stamps), unemployment benefits, workers compensation, General Assistance, federal and state disability benefits (temporary or permanent), the Lifeline program for telephones and internet, and the Low Income Home Energy Assistance Program (LIHEAP) for gas and electricity. New legislation may also create additional programs to assist with water and internet bills.
- **States can help with collection of child support and with subsidized childcare**. Every state has a program to help custodial spouses collect unpaid child support.
- **Help is available after a disaster**. The federal government and many state governments offer special help in areas that have been subject to an emergency declaration. For example, during the COVID-19 pandemic, state and federal governments provided much needed stimulus to consumers, including but not limited to advance child tax credits, economic impact payments, enhanced rental and housing assistance, small business loans, and utility and telecommunication assistance.
- **Savings may be available**. Consumers may have exhausted any money left in a savings account by the time they look to a high cost loan, but for those who have not, it might not make sense to hold onto savings (other than retirement savings) at the expense of a high-cost loan.
- **Assets can be sold.** A variety of household goods, including electronics, jewelry, antiques, and other personal assets may be converted into cash if consumers are willing to part with them. But consumers should stay away from auto title pawns.
- **Churches and other charitable community organizations offer assistance.** Many faith organizations, local governments, and charities have programs specifically designed to help consumers who are facing an economic emergency, including providing free food, free clothing, and other essentials, and a financial coach can help direct consumers to resources such as assistance to prevent eviction.