Bankrupt by Design: Payday Lenders Target Pennsylvania Working Families

Pennsylvania's payday lending bill would transfer money from Main Street Pennsylvania to Wall Street, while stifling economic security in low-Income rural and urban areas

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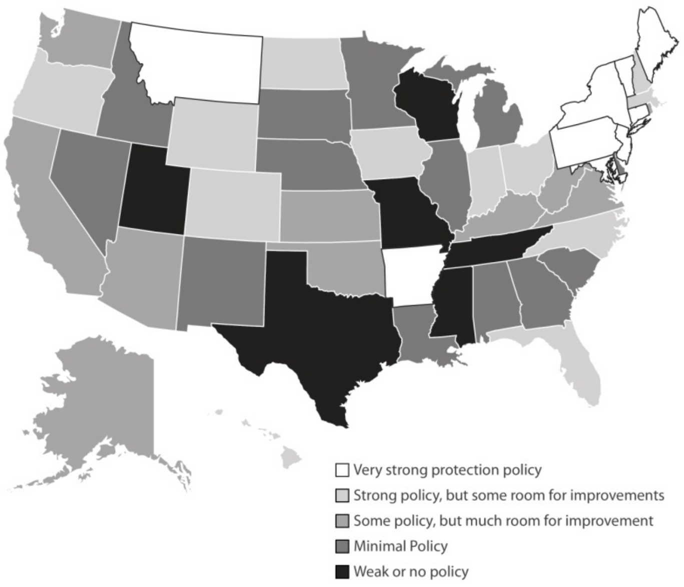
Overview

Pennsylvania has a model law for protecting consumers from predatory payday lending. Currently, state law limits the annual percentage interest rate (APR) on small loans to approximately 24%. The Pennsylvania House of Representatives, however, is poised to consider legislation that would substantially weaken consumer protections against predatory payday lending, putting Pennsylvania families and jobs at risk.

The Corporation for Enterprise Development ranks Pennsylvania's current policy as providing the strongest protections for consumers against payday loans.[1] This strong protection from payday lenders saves Pennsylvania consumers an estimated $234 million in excessive fees each year.[2]

Strength of State Policies Protecting Consumers from PayDay Lending


□ Very strong protection policy
□ Strong policy, but some room for improvements
▨ Some policy, but much room for improvement
▨ Minimal Policy
■ Weak or no policy

Source. The Corporation for Enterprise Development

Despite having a model law in place, Pennsylvania lawmakers have introduced House Bill 2191, promoted by payday lenders, to relax consumer protections from payday lending. HB 2191, even with proposed amendments described misleadingly as a compromise, would permit a $300 two-week loan to carry a fee of $43, resulting in a 369% APR. In short, out-of-state payday lenders are seeking a carve out from Pennsylvania's lending laws to legalize payday lending at triple-digit interest rates.

Research and experience in other states shows that payday loans with triple-digit APRs and quick due dates lead to the accumulation of long-term debt for working families, rather than serving as timely financial aid, as the industry often claims. Customers typically do not use a payday lender just once; the average payday borrower takes out nine payday loans per year.[3] Many borrowers cannot afford to pay back the principal, let alone the principal plus high interest and fees, two weeks or less after borrowing.

[1] The Corporation of Enterprise Development, Assets and Opportunity Score Card available online at http://scorecard.assetsandopportunity.org/2012/measure/protections-from-predatory-short-term-loans?state=pa

[2] Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year*. Center for Responsible Lending, November 30, 2006. Available online at http://goo.gl/oHNNJ

[3] Page 7 of Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year*. Center for Responsible Lending, November 30, 2006. Available online at http://goo.gl/oHNNJ

When borrowers do pay back the loan, they often need an additional loan to meet their already established bills and obligations. The structure of the payday product itself exploits the already stretched budgets of low- and moderate-income families by luring them into a debt trap.

Contrary to the claims of its supporters, HB 2191 would not create new economic activity in Pennsylvania. It will create some near poverty-wage, high-turnover jobs at storefront payday lending locations. Beyond this, legalizing payday lending will reduce spending and therefore employment in other sectors of the Pennsylvania economy. The excessive fees typical of payday loans leave working families with less money to spend on goods and services, such as rent and food, in the process erasing an estimated 1,843 good jobs. In this way, HB 2191 would transfer money from Main Street Pennsylvania to out-of-state and foreign payday lending corporations. We should strive to create jobs that provide an economic net benefit and not ones that leave families trapped in debt.

What is Payday Lending?

Payday lending encompasses small loans, usually for two weeks or less, that require a post-dated check or electronic access to a borrower's bank account as a condition of the loan.

How To Calculate The Annual Percentage Rate

HB 2191 and the federal Truth in Lending Act require the cost of payday loans to be disclosed as an Annual Percentage Rate or APR. It is the only standard measure by which consumers can compare the costs of credit.

Here is how to calculate an APR for a typical $300 loan due in full in 14 days under HB 2191.

- APR = (Total Fees ÷ Amount Financed ÷ Loan Term (in days))*365 days*100
- APR = ($42.50 ÷ $300 ÷ 14 days) * 365 days * 100
- APR = 369%

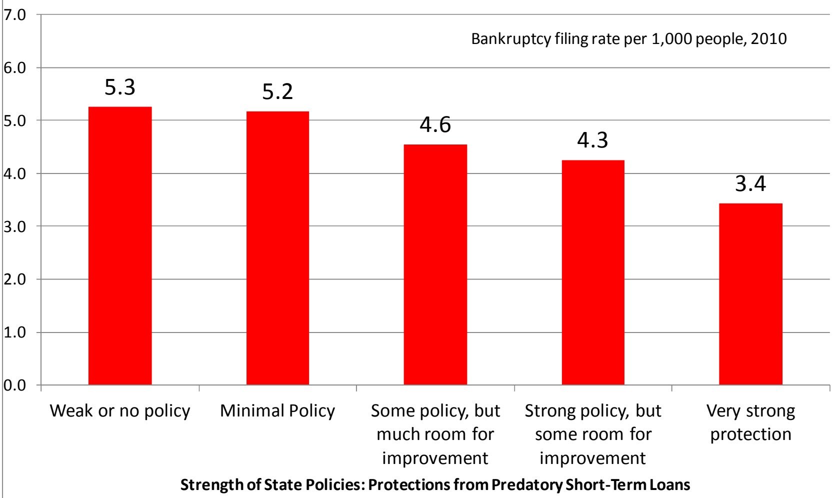
By comparison, a $500 cash advance from a credit card typically carries a 30% APR, well under one-tenth of the payday lending APR.

Fees and interest in states that allow payday lending typically total $15 to $17 for every $100 borrowed—an effective annual percentage rate of more than 300 percent for a loan due in full in 14-days.

Payday loans are made without any serious assessment of a borrower's ability to repay the loan. While payday lenders often claim that searching a database for a borrower's outstanding payday loans or allowing loans up to 25% of a borrower's income counts as underwriting (the evaluation traditionally done in banking of a borrower's ability to pay), it does not. Importantly, payday lenders typically fail to look at the borrower's other obligations. As a result, when the loan is due in full on the borrower's next payday, many borrowers are in the same or worse financial situation. However, because the borrower provided the payday lender with a post-dated check when that next pay day arrives the payday lender is first to be paid, leaving the borrower short of the amount they borrowed plus a high fee. It is no surprise then the typical payday borrower takes out multiple loans over the year, each time falling further behind on their bills as they rack up payday lending fees. Ultimately, payday borrowers are twice as likely to file for bankruptcy as applicants whose request for a payday loan was denied by the lender.[4]

As Figure 1 illustrates, the states that the Corporation for Enterprise Development identifies as providing the strongest protections for consumers against payday loans, including Pennsylvania, also have the lowest bankruptcy rates. In 2010, there were three bankruptcies for every 1,000 people in Pennsylvania compared to over five bankruptcies per 1,000 people in states that have minimal or weak protections from payday lenders.

Figure 1. Strong Protections For Consumers From Short Term Lending



Source. Keystone Research Center based on Corporation for Enterprise Development and American Bankruptcy Institute data

Current Payday Lending Law in Pennsylvania

It is not often that Pennsylvania can tout having a model law, but we currently have one of the top "payday lending" laws in the nation, protecting Pennsylvanians from being charged very high interest rates.

The current Pennsylvania cap is an annual interest rate of approximately 24%, a tiny fraction of the high interest rates that accompany traditional payday lending in other states. The Pennsylvania Supreme Court in 2010 strengthened the state's payday lending law by ruling that online and out-of-state lenders must follow the law when they operate in Pennsylvania. In addition, alternative lending options exist allowing consumers to take out small loans without being charged excessively high annual interest rates.[5]

Why Pass Legislation To Permit Abusive Payday Lending?

The payday lending industry claims that allowing triple-digit interests rates will create a few thousand jobs in Pennsylvania. The industry shows in its fine print that it assumes these jobs would pay $25,000 each in total annual wages, about $12 per hour for a full-time, full-year worker. In sum, these would be

[4] Skiba, Paige Marta and Jeremy Tobacman, *Do Payday Loans Cause Bankruptcy?*, Vanderbilt Law and Economics Research Paper No. 11-13, November 9, 2009. Available online http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1266215.

[5] For example, the Credit Union Better Choice is a short-term loan program jointly sponsored by the Pennsylvania Credit Union Association, the Pennsylvania Treasury Department and the Pennsylvania Department of Banking. http://www.pacreditunions.com/betterchoice.html

near-poverty level wages. (Accepting the industry's claims about job creation, the total annual income from these jobs would be $72 million.) Illustrative of how low quality these jobs are: Advance America, the nation's largest payday lender, reports that non-managerial turnover at its storefront locations was 120%, with more than half of that turnover occurring within six months of employment. Among storefront managers, the annual turnover rate was 58%.[6]

Payday lenders claim that they would create new economic activity in the Commonwealth by providing liquidity to Pennsylvania consumers in need of small loans. In reality, a consumer that takes out a small loan of $500 to pay off a medical bill today will still have to pay back that $500 plus the $67.50 interest and fees, in only 14 days. If that consumer had simply worked out a repayment plan to pay back the medical bill over time, they would have just paid the $500 (possibly with a small interest fee). And, given that the typical payday borrower takes out nine payday loans a year, often in back-to-back transactions, that consumer will likely pay $607.50 in interest and fees and still owe the original $500. The fees and interest typically paid on payday loans represent $607.50 of spending that would have otherwise been used to purchase other goods and services in the economy. To take a recent concrete example, a Havertown insurance adjuster who borrowed $250 from Texas-based Cash America ended up paying nearly $2,000 in finance charges over the course of a year.[7]

Under current law, this type of payday lending is illegal in Pennsylvania. HB 2191 would welcome it back to the state. Even accepting industry claims about job creation, HB 2191 would sap spending power from our struggling economy. Recall that the total spending power the industry claims from low-wage jobs in storefront payday lenders was $72 million. The Center for Responsible Lending[8] estimated in 2006 that Pennsylvania's current law banning abusive forms of pay day lending saved Pennsylvania consumers $234 million in excessive fees. By legalizing abusive lending, HB 2191 will remove from the pockets of low-income families over three times as much income as the industry claims it would pay to workers in new jobs.[9] This loss in spending power among cash-strapped working families would mean less paid in rent, groceries, health care and transportation, so that Wall Street-backed out-of-state lenders can pocket usurious interest and payments.[10]

[6] It is of note that these turnover rates are from 2007 prior to the recession (http://www.sec.gov/Archives/edgar/data/1299704/000104746908002021/0001047469-08-002021-index.htm). As a result of the current high level of unemployment, workers are much less likely to leave jobs for fear they may not easily find a new one. As a result, turnover rates for managerial and non-managerial staff at Advance America have fallen but remain very high at 26% and 53% respectively in 2011 (http://www.sec.gov/Archives/edgar/data/1299704/000104746912002758/0001047469-12-002758.txt).

[7] Jeff Gelles, "Consumer 12.0: Online payday loan firms open flout Pa. laws," *The Philadelphia Inquirer*, April 29, 2012. Available online http://articles.philly.com/2012-04-29/business/31475006_1_online-payday-payday-lenders-internet-lender.

[8] Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year*. Center for Responsible Lending, November 30, 2006. Available online at http://goo.gl/oHNNJ

[9] Lobbyists for the industry have claimed firms in the industry would spend $72 million on wages and benefits in Pennsylvania if HB 2191 was passed.

[10] Three large payday lenders that have sought to make loans illegally in the Commonwealth and would benefit from HB 2191 are Mexico-based Advance America, Texas-based CashAmerica and Ohio-based Axcess Financial.

What would be the jobs impact from the extraction of fees and interest by payday lenders? Since payday borrowers are, by definition, living paycheck to paycheck, it is reasonable to assume that, if they do not pay payday lenders, they would spend that money on consumption. To estimate the impact of this spending on jobs, we can use job multipliers for government programs that target low-income families (such as food stamps). Based on the available estimates, a decline in spending of $234 million would lead to the loss of 1,843 jobs. (These are not poverty-wage jobs but typical or average—i.e., middle-class—jobs.[11]) This job loss is an extremely conservative estimate because it ignores the economic costs imposed on individuals and communities by the increased incidence of bankruptcy.

Predatory Payday Lenders Target Low-Income Rural & Urban Areas

Most of the reduction in purchasing power and jobs resulting from payday lending would take place in low-income rural and urban counties where most low-income workers live. While no data of this kind for Pennsylvania has been published, in Kentucky and Ohio payday lending concentrates particularly in low-income rural areas.[12]

Payday Lenders' Business Model and Profitability Depend on Driving Families Deeper Into Debt

Payday loans are profitable for the companies that offer them precisely because customers don't use payday loans just once and then stabilize their financial situation. Instead, they take out many payday loans and, as a result, pay the fees several times over. In fact, for typical customers, given the high interest rates and short loan terms, it is difficult for most payday lending customers to pay back their loans on time without taking out another loan. This is particularly true for families on fixed incomes, such as those receiving Social Security, retirement, or disability payments.

Table 1 shows conservative two-week spending patterns (or budgets) for an average household making $25,000, $35,000, or $45,000 per year. These three family budgets are based on surveys of actual family spending patterns (drawn from the Consumer Expenditure Survey (CES) administered by the Bureau of Labor Statistics) and include expenses such as food, housing, utilities, transportation, and basic health

[11] Conservatively, if we treat payday lending as a transfer of income from low-income consumers to high-income consumers, we would expect a multiplier of 1; meaning each dollar of excessive fees leads to a loss of a dollar of economic activity (1 * $234 million = $234 million). The Economic Policy Institute's Josh Bivens estimates that each $127,000 in economic activity corresponds to one payroll job ($234 million / $127,000 = 1,843 jobs). See Bivens, Josh L. 2011 Method memo on estimating the jobs impacts of various policy changes. Washington, D.C.: Economic Policy Institute. Available online at http://www.epi.org/publication/methodology-estimating-jobs-impact/

[12] Analysis by the Kentucky Coalition for Responsible Lending found that "Twelve of the thirteen counties with three or more payday lenders per 10,000 people are home to less than 50,000 Kentuckians" see *The Debt Trap in the Commonwealth: The Impact of Payday Lending on Kentucky Counties*, available online http://www.maced.org/files/KCRL_IssueBrief_med-res.pdf. Similarly David Rothstein of Policy Matters Ohio found that less populated rural Ohio counties had more lenders per capita than urban areas. See *The Continued Growth of Payday Lending in Ohio,* available online http://www.policymattersohio.org/the-continued-growth-of-payday-lending-in-ohio.

care. They do not include additional costs such as child care, clothing, and previous debts, including credit cards or car loans.

A borrower who takes out a $300 payday loan in one two-week period must in the current period repay $300 in principal plus $46 in interest and fees. Based on the CES, families earning $25,000 or $35,000 would be unable to make up the cost of the payday loan and meet other basic expenses. A family making $45,000 would be in slightly better shape and, considering these expenses only, would not have a negative balance after paying off the loan. These examples demonstrate why the majority of borrowers are repeat borrowers, taking out loan after loan as fees force them to fall further and further behind. Given these data, it is no surprise that the average payday lending consumer takes out nine payday loans annually.[13]

Table 1.

Family Budgets and Payday Loans

Income before tax	**$25,000**	**$35,000**	**$45,000**
Income per 2 week period	$962	$1,346	$1,731
Federal Taxes	-$12	-$5	$1
State and Local Taxes	$5	$7	$9
Pension/Social Security	$51	$74	$96
Income per 2 week period after taxes	**$917**	**$1,270**	**$1,624**
Average Household Size	2.3	2.5	2.6
Household Expenditures per 2 week period			
Food	$151	$182	$213
Housing (including utilities)	$408	$480	$551
Transportation	$179	$226	$272
Healthcare	$95	$105	$116
Total Expenditures	$833	$993	$1,152
Net Paycheck Minus Essentials	**$84**	**$278**	**$471**
Amount Due on $300 Loan	**$343**	**$343**	**$343**
Pay period net if payday loan paid on time	-$258	-$65	$129

Source. Keystone Research Center analysis of 2010 Consumer Expenditure Survey data

At present in Pennsylvania, payday lending at annual interest rates of 300% or more is illegal as well as immoral. Let’s keep it that way.

[13] Page 7 of Uriah King, Leslie Parrish and Ozlem Tanik, *Financial Quicksand: Payday lending sinks borrowers in debt with $4.2 billion in predatory fees every year*. Center for Responsible Lending, November 30, 2006. Available online at http://goo.gl/oHNNJ