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# Hearing on "Bank On California"

Testimony before the
Committee on Banking and Finance
California State Assembly
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***This testimony is not intended for public release before February 6 at 1pm Pacific Time***

Thank you Chairman Dickinson, Vice Chairman Morrell, and members of the Committee for the opportunity to discuss the important work that you and those involved in the Bank On movement are doing in an effort to improve the financial strength of households in California and elsewhere.

The Pew Charitable Trusts is an independent non-profit organization. Pew applies a rigorous, analytical approach to improve public policy, inform the public and stimulate civic life. A key focus of our work is to generate high-quality research that helps inform those, such as yourselves, who are working to solve today's most challenging policy issues.

I am a project director within Pew's family economic security portfolio. Over the past six-and-a-half years, I have overseen Pew's consumer credit initiatives, such as research on credit cards and payday loans, and contributed to our work on prepaid debit cards, the un- and under-banked, and similar topics. Prior to joining Pew I worked in the private sector on behalf of credit card companies and other consumer finance providers.

I will refer to a number of Pew publications in my testimony. Some of these publications are several years old and were conducted under Pew's safe banking opportunities project (www.pewtrusts.org/safebanking), which provided research and technical assistance to help more than 50 cities and localities kick off "Bank On" programs throughout the country, and also completed a multi-phase survey of 2,000 low-income households in the Los Angeles Area. I will also refer today to more recent research from Pew's safe small-dollar loans project (www.pewtrusts.org/small-loans), the safe checking project (www.pewtrusts.org/safechecking), and our prepaid cards research project (www.pewtrusts.org/prepaid), which today is publishing two new reports about this rapidly-growing market segment.

To begin, I would like to recognize that having a bank account is something that most consumers want: Even in the wake of the financial crisis, most of the consumers we have interviewed who do not currently have bank accounts aspire to have one in the future.[1] And of course, having a bank

[1] For example, a majority of low-income Los Angeles respondents who have experience with both bank and non-bank providers said they prefer the customer service and locations of banks over check cashers. The Pew Charitable Trusts, *Slipping Behind* (2011), 1, http://www.pewtrusts.org/our_work_report_detail.aspx?id=85899365257. Also, Pew's national survey of prepaid cardholders shows that most prepaid users *also* have a checking account, and most who do *not*

account helps many consumers build financial strength by providing opportunities to save, and in many cases, obtain loans to help improve their lives or build businesses.[2]

But my comments today will focus on a trend that has important implications for the success of any effort to connect American families with beneficial financial services. I will show that millions of Americans are turning away from banks for some or all of their financial needs, because non-bank products are providing something the banks—including many Bank On participating banks—are not. For many, that something is better control over their finances. It is shelter from overdraft fees and security against overspending and the temptations of credit.

This is the key point of my comments today: If increasing the number of families who have bank accounts is to continue to be a goal of many policy makers, we must understand consumers' short-term needs for gaining control over their budgets and avoiding the risk of overspending or triggering overdraft fees. Attempts to serve this market—including Bank On programs—will be more successful if they are designed to help achieve these goals.

## 1. **<u>There is a large and apparently growing group of consumers who have used the banking system but are going outside of it for some or all of their financial services needs</u>**

Many people who have bank accounts also use non-bank financial services providers. In Los Angeles, about one-third of low-income households who have bank accounts also use non-bank services. For example, many of these consumers explained that they use check cashers due to the speed and convenience of their services.[3]

Looking at it in reverse, many people who use non-bank financial services *also have* a bank account. For example, consider the case of general purpose reloadable prepaid cards.[4] Nationwide, 88 percent of prepaid debit card users either *have or used to have* a checking account (59 percent of all prepaid users *currently* have a checking account). In other words, the vast majority of people who use prepaid cards have experience with bank accounts but have opted to

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have a checking account aspire to have one in the future. The Pew Charitable Trusts, *Why Americans Use Prepaid Cards* (2014), 7, 11, www.pewtrusts.org/prepaid.

[2] There is a correlation between having a bank account and saving. In Pew's multi-phase study of low-income Los Angeles households, more than twice as many banked (24 percent) as unbanked (11 percent) respondents reported that they were earning enough to pay their bills and save for the future. The Pew Charitable Trusts, *Unbanked By Choice: A Look at How Low-Income Los Angeles Households Manage the Money They Earn* (2010), 2, www.pewhealth.org/reports-analysis/reports/unbanked-by-choice-85899367643. Similarly, among prepaid debit card users, those who also have checking accounts report higher levels of saving than those who do not. The Pew Charitable Trusts, *Why Americans Use Prepaid Cards: A Survey of Cardholders Motivations and Views* (2014), 17, www.pewtrusts.org/prepaid. It is possible that this correlation may be a function of income (i.e. those with bank accounts will tend to have higher incomes in general), or the fact that those who open bank accounts are inherently more prone to plan for the future. In general, it would be useful to add research projects to the agenda of programs such as Bank On to help better understand the connections between bank account ownership and savings behavior. Still, it is important to note that even low-income households have been shown to save under favorable circumstances. *See, e.g.*, Michael Sherraden, "Assets and the Poor" (1991); Michael Schreiner and Michael Sherraden, "Can the Poor Save?" (2006); and the D2D Fund's *Tax Time Savings* project, www.d2dfund.org/tax_time_savings.

[3] The Pew Charitable Trusts, *Unbanked By Choice* (2010).

[4] General purpose reloadable prepaid cards are widely available to the public, allow customers to load funds via cash and direct deposit, and provide the ability to spend money at unaffiliated merchants and to access funds through ATMs. Gift or other cards that are not generally accepted by merchants and reloadable by consumers are *not* included in this definition. Prepaid cards are not checking accounts; most consumers obtain them from non-bank providers.

go outside the banking system for some or all of their financial services.[5] (The prepaid card market is growing rapidly; a short summary of who uses prepaid cards is attached at the end of this comment letter.)

## 2. The desire to gain control over one's finances—and avoid overdraft and the temptations of credit—is leadings millions to seek services outside the banking system

The fact that so many prepaid card users have or used to have bank accounts raises an important question: Why are so many people looking for financial services outside the banking system? Pew's nationally representative survey data show clearly that prepaid card users are trying to regain control of their financial lives, chiefly by avoiding debt; not spending more money than they have; getting shelter from overdraft and other fees; and avoiding the temptations of credit.

| | Major Reason | Total Reason |
|---|---|---|
| Control Spending | | |
| Avoiding credit card debt | 52 % | 67 % |
| Helping you not spend more money than you actually have | 51 | 66 |
| Dividing spending into budget categories | 30 | 54 |
| Control Fees | | |
| Avoiding overdraft fees | 46 | 63 |
| Avoiding check-cashing fees | 38 | 57 |
| Make Purchases | | |
| Making purchases online and other places that don't accept cash | 51 | 72 |
| Allowing you to conduct transactions more anonymously | 35 | 56 |
| You would not be approved for a checking account | 26 | 44 |

Source: The Pew Charitable Trusts, 2014.[6]

And the reason that consumers are turning to *prepaid cards* to find this control is also clear: prepaid cards on the market today generally do not let consumers spend more money than they load onto the cards in the first place. In Pew's analysis, only eight percent of prepaid cards from the major national providers disclose an overdraft feature. The vast majority of cards explicitly disclose that overdraft is not possible (80 percent).[7]

Contrast that to the checking accounts offered by the nation's banks and credit unions, where overdraft penalty fees are ubiquitous,[8] median charges are $25 per overdraft for credit unions or $35 for banks, and customers can typically be charged four such fees per day.[9] This type of

[5] The Pew Charitable Trusts, *Why Americans Use Prepaid Cards* (2014), 7.
[6] Ibid., 14
[7] The Pew Charitable Trusts, *Consumers Continue to Load Up on Prepaid Cards* (2014), 9-10, www.pewtrusts.org/prepaid.
[8] The Pew Charitable Trusts, *Hidden Risks: The Case for Safe and Transparent Checking Accounts* (2011), www.pewstates.org/uploadedFiles/PCS_Assets/2011/SafeChecking_Pew_Report_HiddenRisks.pdf.
[9] The Pew Charitable Trusts, *Still Risky: An Update on the Safety and Transparency of Checking Accounts* (2012), 39, www.pewstates.org/uploadedFiles/PCS_Assets/2012/Pew_Safe_Checking_Still_Risky.pdf.

overdraft fee arrangement is also part of many checking accounts offered under Bank On programs.[10]

A 2012 Pew survey showed that a strong majority of checking account holders nationwide feel that such overdraft programs are more harmful than helpful, and 75 percent of checking account customers said they would rather have a transaction declined than incur an overdraft fee. New opt-in disclosures mandated in 2010 by the Federal Reserve have not resolved this situation: More than half of those who overdrafted since that time did not believe that they had opted in.[11]

Together, these findings show that when consumers choose prepaid cards, they are often seeking—and are generally finding—shelter from the risk of overdraft and overspending.[12]

## 3. Prepaid card users do not want the product to have overdraft or linked credit

Prepaid users want their cards to remain free of overdraft and automated or linked credit features. One driver of this sentiment is past experience. As noted above, the vast majority of prepaid card users have or used to have a bank account. Of these, 41 percent have closed or lost a checking account because of overdraft fees.[13] Thus, it is not surprising that 63 percent of prepaid users cite "avoiding overdraft fees" as a reason for using the card, with similar majorities saying they use the card for "avoiding credit card debt," and "helping you not spend more money than you actually have."[14]

Prepaid card users view mechanisms that would allow them to spend more money than they have as self-defeating. They find credit options tempting, and got a prepaid card to help them avoid the risk of overspending and overdraft fees. Altogether, 71 percent of prepaid users say they would *not* like to have the ability to overdraft their card balance for a fee, with 69 percent rejecting linked payday loans and 63 percent rejecting linked lines of credit. As one prepaid card user said in a Pew focus group, with credit features "it will turn into a credit card, and it will not be a prepaid card anymore. It will lose its meaning."[15]

## 4. Lessons from prepaid for Bank On and policies to promote access to banking

The case of prepaid cards demonstrates that there is a large and rapidly growing market for non-bank transaction accounts. Most prepaid cards offer the functionality of a checking account

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[10] For example, the accounts featured under one Bank On program all disclose overdraft fees (a minority disclose a waiver of the first overdraft fee). Bank On San Francisco, *Participating Institutions Directory* (2012), 5, http://bankonsanfrancisco.com/wp-content/uploads/2013/08/Bank-On-Directory_rev-6-7-2013.pdf.
[11] The Pew Charitable Trusts, *Overdraft America: Confusion and Concerns About Bank Practices* (2012), www.pewstates.org/uploadedFiles/PCS_Assets/2012/SC-IB-Overdraft%20America(1).pdf.
[12] Unfortunately, these benefits of prepaid cards may not last. Prepaid card providers typically retain the contractual right to change terms at any time for any reason, and there is little or no regulatory protection against overdraft or linked lines of credit. Policymakers should prevent overdraft and linked or automated lines of credit from proliferating in this market as a way of preserving the "prepaid" nature of the product and helping preserve the control mechanism that has drawn consumers to adopt it. For Pew's policy recommendations, see The Pew Charitable Trusts, *Consumers Continue to Load Up on Prepaid Cards* (2014).
[13] The Pew Charitable Trusts, *Why Americans Use Prepaid Cards (2014)*, 8.
[14] Ibid, 14.
[15] Ibid., 21.

(direct deposit, ATM access, and in some cases even check writing)[16] with one key distinction: no overdraft or ability to spend more than they have deposited. The fact that the majority of prepaid users *also have* a checking account strongly suggests that they are looking for services or features that banks are not providing. The strength of consumer opinion in favor of more control, and against overdraft and overspending, tells us what many consumers are looking for when they go outside the bank system. Yet bank checking accounts—including those offered through Bank On programs—continue to place overdraft as a core product feature.

Looking forward, efforts to increase access to beneficial banking services must take these findings into account. Efforts that help consumers meet the goal of avoiding overdrafting and overspending will be more likely to succeed; efforts that do not take this goal into account or put consumers at risk will be more likely to fail. Policymakers should ensure that overdraft and automated or linked lines of credit do not spread into the prepaid card market,[17] and anyone interested in promoting consumers' relationships with banks should encourage banks to provide products that better help consumers achieve their goals of avoiding overdraft and resisting overspending. Otherwise, more consumers may conclude that banks are too risky and decide to shift more of their financial business outside the banking system; and some who have bank accounts may continue to lose or abandon them altogether.[18]

## 5. <u>The benefits of being banked can also include access to credit—but there are limits to this benefit</u>

Through various focus groups and interviews, we have seen that consumers continue to think of being banked as a sign of success and a doorway to opportunities such as starting businesses and owning homes. In many cases, these opportunities stem from the ability to build a positive credit history and gain access to productive forms of credit. But policies designed to promote access to credit must be carefully structured to avoid pushing those who are already over-indebted deeper into financial distress.

Most people agree that improving access to credit is a worthy goal. But usually when we discuss this goal, we are implicitly talking about underserved or **"thin file"** consumers, including recent immigrants, young adults, and others with limited credit histories.[19] Thin file consumers can benefit in many ways from gaining access to the mainstream market for credit cards, auto loans, mortgages, and so on. Promoting consumer relationships with banks, and programs to help thin file consumers gain experience in the credit market and build credit files, can lead to beneficial and productive outcomes that help families improve their financial security.

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[16] Though prepaid cards generally have a version of deposit insurance and liability limits for unauthorized transactions, they are generally inferior to those on bank checking accounts—something policy makers should address. The Pew Charitable Trusts, *Consumers Continue to Load Up on Prepaid Cards* (2014).

[17] For Pew's policy recommendations, s*ee* The Pew Charitable Trusts, *Consumers Continue to Load Up on Prepaid Cards* (2014).

[18] One-third of all consumers who have had a checking account in the past report that they have closed a checking account because of overdraft fees. The Pew Charitable Trusts, *Overdraft America* (2012), 7. Between 2009 and 2010, the ranks of the unbanked in low-income Los Angeles neighborhoods increased because more families left banking than joined it. One-third of those who left cited unexpected or unexplained fees as their reason for closing their bank accounts. The Pew Charitable Trusts, *Slipping Behind* (2011).

[19] "Thin file" refers to consumer credit reports that have little or no data in them, meaning that potential creditors have relatively little information upon which to base an underwriting decision.

But it is vital to remember that millions of Americans fall into another category: **"thick file"** consumers who are already carrying debt and are struggling to keep up with their bills. A good example of this type of consumer is the payday loan borrower, and the case of payday loans provides a cautionary tale for anyone studying whether and how to promote access to credit.

Payday loans offer several hundred dollars in cash to almost anyone who has an income source and a checking account—i.e., payday borrowers are *banked* consumers. In exchange, lenders charge a fee and have the right to withdraw repayment in full from the borrower's checking account on his or her next payday. Payday loans are advertised as a two-week product for a fixed fee of about $50, but borrowers end up in debt for an average of five months of the year and pay $520 in fees.[20] The reason for this disconnect between packaging and usage is that the average loan requires a repayment of more than $400 in two weeks—an amount equal to *one-third* of a typical borrower's next paycheck—whereas the average borrower can afford only about $50, or 5 percent of the next paycheck.[21]

Instead of assessing the borrower's ability to repay the loan, payday lenders rely on having the right to take full repayment directly from the borrower's checking account on his or her next payday. This ability to collect payment before the customer pays other bills, such as rent or utilities, is unique to payday lenders, and it allows them to thrive even as they make loans to borrowers who cannot afford them. When the loan is due, customers can afford to renew or reborrow the loan for a fee ($55 on average at payday loan stores), but they cannot afford to retire the debt in a lump-sum payment. Consequently, borrowers repeatedly pay fees to renew or reborrow the money for an average of five months of the year.[22]

Pew's research has shown that those who take out payday loans routinely struggle to keep up with ordinary living expenses. Most often, they use the loans to pay rent, utility bills, and other routine obligations (as opposed to dealing with unexpected emergencies, or spreading the cost of purchases over time, which is a more traditional use of credit).[23]

Almost all payday borrowers have a credit score, with an average score in the low 500s,[24] indicating an assessment by credit reporting agencies that payday borrowers are already overburdened with debt and/or struggling to meet financial obligations. More than half of payday

[20] The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2014), 4-5. www.pewstates.org/research/reports/payday-lending-in-america-policy-solutions-85899513326.

[21] Ibid., 29-30, 53.

[22] Ibid., 4-5, 53. Payday lenders obtain this unique leverage over borrowers based on deferred presentment (holding the borrower's postdated check) or having electronic access to the borrower's checking account. The fact that the average consumer renews or reborrows the loans for five months during the year is essential to the business model: Lenders depend on repeat borrowing, because they would not earn enough revenue to stay in business if the average customer paid off the loan within a few weeks. Note that California payday loans are limited by law to $255 or less; consequently California's numbers differ slightly from national averages, and California's payday loans take 25 percent of a typical borrower's next paycheck, still far exceeding what typical borrowers can afford.

[23] Fifty-eight percent of payday loan borrowers have trouble paying their bills at least half the time. The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 10), www.pewstates.org/research/reports/how-borrowers-choose-and-repay-payday-loans-85899452131. Seven in 10 borrowers use payday loans to cover ordinary living expenses, such as rent or utilities. The Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why* (2012), 8, www.pewstates.org/research/reports/who-borrows-where-they-borrow-and-why-85899405043.

[24] Neil Bhutta, Paige Marta Skiba, and Jeremy Tobacman, "Payday Loan Choices and Consequences," Vanderbilt Law and Economics Research Paper, no. 12-30 (2012), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2160947.

loan applicants already carry credit card debt, two in five payday borrowers own homes (many with mortgages), and many also hold student loans, auto loans, and other debt.[25]

The result for consumers is not positive. After seeking loans to help them pay their bills and debts, they find that the loans themselves take up one-third of their paychecks, making it difficult or impossible to pay future bills. And payday loans do not eliminate the risk of overdraft: Most payday borrowers *also pay* overdraft fees, and one-quarter of borrowers report that a withdrawal by a payday lender *caused* an overdraft.[26]

In short, payday borrowers are thick file consumers who are struggling to manage existing debts and falling behind in paying their bills. But rather than helping, payday loans become yet another burden for the typical borrower. That is why Pew has concluded that the conventional, lump-sum payday loan is a failed product.

The payday lending experiment began in this country about 25 years ago, and 35 states including California currently have special laws that allow the loans to proliferate. Many policymakers supported this expansion, driven by a good-faith desire to increase access to credit to this financially fragile population. But the expansion in lending came at a high cost: the abandonment of one of the most fundamental tenets of consumer lending, the concept that the borrower must have the ability to repay the loan as agreed, without having to borrow again to meet other obligations.

As explained above, payday lenders are unique because they do not underwrite to assess the borrower's ability to repay, and instead rely on having the right to take payment directly from the borrower's checking account on the next payday. Though in theory such short-cuts in the underwriting process may help companies avoid underwriting cost and expedite more loans to more people in a way that helps consumers, this experiment has failed because in most cases the lump-sum payment required makes the average consumer's financial situation worse.[27] Better would be a system that ensures loan payments do not exceed borrowers' ability to repay, especially for those who are already financially overburdened like the typical payday loan customer.

Not surprisingly, payday borrowers overwhelmingly want something different:[28]

- Despite feeling grateful to receive cash in a time of need, and despite appreciation for friendly customer service offered at payday loan stores, a majority of borrowers say payday loans take advantage of them.

- By almost a 3-1 ratio, borrowers favor more regulation of the loans.

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[25] The Pew Charitable Trusts, *Payday Lending in America: Policy Choices* (2014), 26. Pew's safe small-dollar loans project has studied payday and small-dollar loan issues extensively since 2011. For more information, see www.pewtrusts.org/small-loans.
[26] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans* (2013), 32-34. *See also* Consumer Financial Protection Bureau, *Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings* (2013), http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.
[27] For a summary of the payday lending problem, how the market emerged, and how lawmakers in the past dealt with similar problems, see The Pew Charitable Trusts, *Payday Lending in America: Policy Solutions* (2013), 4-6.
[28] The Pew Charitable Trusts, *Payday Lending in America: How Borrowers Choose and Repay Payday Loans (2013)*, 40; and *Policy Solutions* (2013), 22-24.

- 8 in 10 borrowers favor a requirement that payments take up only a small amount of each paycheck.

- 9 in 10 favor allowing borrowers to pay back loans in installments.

## 6. Lessons from payday for Bank On and policies to promote access to credit

The potential benefits of access to credit are very different for "thin file" consumers who have little experience in the mainstream credit market, than for "thick file" consumers who have already become over-indebted and are struggling.

Promoting access to credit for thin file consumers can help families leverage credit cards, auto loans and mortgages to build a strong financial future. And working to increase their financial literacy can encourage good decision-making and help ensure that otherwise helpful credit products do not become harmful burdens.

Yet for thick file consumers, the benefits of credit are not so clear. It is entirely possible that consumers who are already struggling with debt have financial problems that cannot be solved by obtaining more credit. Policymakers should not rush to make more credit available at any cost.

But when more credit is made available, a few sensible guidelines must be established to avoid widespread harm. For these reasons, Pew has called on the federal Consumer Financial Protection Bureau and legislators in California and the other 34 states that have lump-sum payday loans to enact fundamental reform of the small-dollar loan market. Pew's recommendations call for restoring the concept of ability to repay by limiting all-small dollar loan payments to an affordable percentage of a borrower's income (research indicates that monthly payments above 5 percent of gross monthly income are unaffordable, and Pew recommends prohibiting larger loan payments unless the lender conducts rigorous underwriting showing that the borrower can afford them). Pew also calls for spreading installment loan costs evenly over the life of the loan; protecting borrower checking accounts against harmful collections practices; requiring concise disclosure of periodic and total costs; and for states, continuing to set maximum allowable charges on loans for those with poor credit.

A two-page summary of Pew's payday and small-dollar lending research, including Pew's policy recommendations, is attached at the end of this comment letter. More information is available in our *Payday Lending in America* report series and on our website, at www.pewtrusts.org/small-loans.

## 7. Conclusion

To achieve the benefits that can accrue to consumers through having access to bank accounts, policymakers must understand that many consumers are being driven away from the banking system by overdraft fees and the risk of overspending, and toward alternatives that help increase control over their finances and achieve budget goals. Programs seeking to promote better banking services for un- and under-banked consumers will be more successful if they are designed to help consumers achieve success in their goal to avoid overspending.

Similarly, programs designed to increase access to credit will be more likely to succeed if they focus on helping thin file (underserved) consumers gain access to mainstream credit products that are beneficial for the average consumer, while helping thick file consumers who are already struggling with bills and debt avoid risky loan products or potentially harmful business practices.

Thank you again for the opportunity to submit comments, and please do not hesitate to contact me with any questions.

Sincerely,

Nick Bourke
Project Director
The Pew Charitable Trusts

Attachment: Summary of General Purpose Reloadable Prepaid Card Users

U.S. consumers loaded about $65 billion onto prepaid cards in 2012, more than double the amount loaded in 2009.[29] The following data points provide a profile of prepaid card users:[30]

- 5 percent of adults, or about 12 million people, use prepaid cards at least once per month.
- The average prepaid customer reports household income of around $30,000 per year.
- Compared to the general population, prepaid card users are more likely to be renters, less likely to be married, more likely to earn less than $25,000, and more likely to be younger than 50 years old.

[29] The Pew Charitable Trusts, *Why Americans Use Prepaid Cards* (2014), 13.
[30] Ibid., 1, 3.

# *Payday Lending in America*

Series summary

Payday loans are controversial. They typically offer about two weeks of credit, due in full on the borrower's next payday, at annual interest rates of around 400 percent. While borrowers find fast relief, they are often left indebted for months, struggling to repay a loan that was marketed as a short-term solution. Proponents argue that payday loans are a useful form of credit for consumers who lack access to more conventional banking services, but opponents claim they overburden people who are already struggling to make ends meet.

The Pew Charitable Trusts' *Payday Lending in America* series details fundamental problems with payday loans and suggests solutions for promoting a safer and more transparent marketplace for small-dollar loans.

## Selected findings

- 12 million Americans take out payday loans each year, spending approximately $7.4 billion annually. The average loan is $375.
- A payday loan is characterized as a short-term solution for unexpected expenses, but the reality is different.
    - The average borrower is in debt for five months during the year, spending $520 in interest to repeatedly reborrow the loan.
    - 69 percent of first-time borrowers use the loan for recurring bills (including rent or utilities), while just 16 percent deal with an unexpected expense such as a car repair.
- Payday loans are unaffordable.
    - Only 1 in 7 borrowers can afford the more than $400 needed, on average, to pay off the full amount of these lump-sum repayment loans by their next payday.
    - Survey and market data show that most borrowers can afford to put no more than 5 percent of their paycheck toward loan payment and still be able to cover basic expenses. In the 35 states that allow lump-sum payday loans, repayment requires about one-third of an average borrower's paycheck.
- Most payday loan borrowers have trouble meeting monthly expenses at least half of the time.
- 41 percent of borrowers have needed a cash infusion, such as a tax refund or help from family or friends, to pay off a payday loan.
- Payday loans do not eliminate overdraft risk. Most borrowers also overdraw their bank accounts.
- A majority of borrowers say payday loans take advantage of them. A majority also say they provide relief.
- Borrowers want changes to payday loans.
    - By almost a 3-1 ratio, borrowers favor more regulation of the loans.
    - 8 in 10 borrowers favor a requirement that payments take up only a small amount of each paycheck.
    - 9 in 10 favor allowing borrowers to pay back the loans in installments.

- Safeguards are needed to ensure affordability and protect consumers from the risk of lender-driven refinancing, noncompetitive pricing, excessive loan durations, and abusive repayment or collection practices.
  - Such safeguards can be applied in a way that works for lenders. Payday lenders continue to operate after a recent law change in Colorado, but borrowers spend less, and payments are far more affordable.
  - In states that enact strong legal protections, the result is a large net decrease in payday loan usage. Rates of online borrowing are similar in states with payday loan storefronts and those with none.

## Policymakers should fix the problems with payday lending in the 35 states where it exists.

The Consumer Financial Protection Bureau and other state and federal policymakers should act now:

- Limit payments to an affordable percentage of a borrower's periodic income.
  (Research indicates that monthly payments above 5 percent of gross monthly income are unaffordable.)
- Spread costs evenly over the life of the loan.
- Guard against harmful repayment or collection practices.
- Require concise disclosures that reveal both periodic and total costs.
- States should continue to set maximum allowable charges on loans for those with poor credit.

## *Payday Lending in America* reports

Who Borrows, Where They Borrow, and Why (2012)
How Borrowers Choose and Repay Payday Loans (2013)
Policy Solutions (2013)

## Other resources available from Pew

Payday Loans Explained (video)
How Payday Loans Work (infographic)
Payday Loan Affordability Fast Facts (infographic)
Payday Borrowers Want Reform (infographic)
Pew's Policy Recommendations to Fix Payday Loan Problems (infographic)

## For more information, please visit:

pewtrusts.org/small-loans

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