PAYDAY LOAN PROHIBITIONS: PROTECTING FINANCIALLY CHALLENGED CONSUMERS OR PUSHING THEM OVER THE EDGE?

William M. Webster, IV*

As the United States seeks to recover from a stubborn economic downturn—with progress that seems to ebb and flow—millions of Americans continue to experience difficulty making ends meet. They increasingly turn to providers of short-term credit for assistance in covering basic expenses, as well as unexpected costs that overwhelm already-stretched budgets. Their credit options may include “traditional” forms of credit, such as bank and credit union loans, and “alternative” financial offerings such as overdraft protection services and various retail lending services.

Payday loans are one such retail option available to these consumers, though they are not without controversy.¹ This service is frequently vilified by industry critics, who typically claim that payday loans are offered at exorbitant interest rates and lock vulnerable or unwitting consumers into a never-ending cycle of debt. Yet, independent research shows, as does the industry’s extensive data and experience, that lenders charge competitive fees for their services and that customers understand their loans’ terms and pricing, typically exhibit a reasoned approach to selecting them, and consider payday loans to be a valuable and cost-effective service.

How are misperceptions shaped between critics’ allegations and actual loan pricing and what consumers decide in the real world? If critics could prevent lenders from offering payday loans, would they in fact be acting in the best interests of those who use these loans, or would they instead be eliminating a reliable option for these consumers, ultimately forcing them to choose more costly or less regulated alternatives?

This article will examine these issues from the perspective of Advance America, Cash Advance Centers, Inc. (Advance America), the country’s largest non-bank provider of cash advance services, with over 2,300 centers in 29 states, as well as additional operations in the United Kingdom and Canada.² In 2010, Advance America extended over $3.7 billion in credit to more than 1.3 million Americans.³

The periodic needs of millions of consumers for short-term, small-dollar credit will be highlighted as will their options for obtaining such credit. The article will also rebut two primary arguments critics make against this industry, specifically the allegations that payday advances

¹ “Payday loans” are often referred to as “payday advances” and “cash advances,” and in this article these terms will be used interchangeably.
³ Id. at 11.
are offered at unreasonably high rates, and that these loans cause most customers to sink into a hopeless “cycle of debt.”

Through an exploration of consumers’ needs and rationale, this article will explain that payday advances are often a consumer’s least expensive and best available credit alternatives—one that customers would be worse off without.

**Consumers’ Need for Small-Dollar, Short-Term Credit Options**

Any discussion of payday lending must be put in the context of the credit needs of American families. Millions of consumers periodically need small-dollar, short-term credit extensions to help them deal with unexpected or unbudgeted expenses. A variety of independent studies and reports extensively document such credit needs, including:

- The Federal Deposit Insurance Corporation issued a widely noted report in December of 2009 which found that about 7.7 percent of U.S. households, approximately 9 million individuals, were “unbanked,” and approximately another 17.9 percent, about 21 million individuals, were “underbanked.”
  Thus, over 25 percent of all American households, representing approximately 60 million adults, were in these “underserved” categories in 2009. Not surprisingly, given the continued stagnation of our economy, high unemployment, and ongoing mortgage crisis, this already large number appears to be growing.

- The FINRA Investor Education Foundation published the results of the first survey in its National Financial Capability Study, also in December of 2009, which contains many troubling findings that a very large percentage of our population has serious and often ongoing financial concerns. Among other things, nearly half of those surveyed reported difficulties in paying bills and meeting monthly expenses. The second and broader survey in this study was released in December of 2010 and found that more than half of all Americans (55 percent) are spending all of, or more than, their household income, and

---

4 Critics make numerous attacks on the payday lending industry. It is well beyond the scope of this paper to respond to all of them. Instead, it will focus on the two allegations that appear to have been their core contentions.

5 FED. DEPOSIT INSURANCE CORP., NAT’L SURVEY OF UNBANKED & UNDERBANKED HOUSEHOLDS 10 (Dec. 2009) [hereinafter FDIC SURVEY], available at http://www.fdic.gov/householdsurvey/full_report.pdf. The FDIC defined “unbanked” to mean that no one in the household currently had a checking or savings account and defined “underbanked” essentially as households that had a checking or savings account, but still relied periodically on alternative financial services, such as payday loans or pawn shops. In this article the term “financially challenged” consumers will be used to refer collectively to both unbanked and underbanked consumers, including more affluent middle and higher income consumers who nonetheless cannot qualify for unsecured personal loans from traditional banks due to their high debt and low disposable income levels and typically their impaired credit history. It should be recognized that payday lenders do not serve the unbanked segment of this market because all customers must have a bank account.

6 Id. at 10-11.


8 Id. at 15.
are living paycheck to paycheck. Moreover, the study reported that 60 percent of Americans do not have adequate funds available to cover unanticipated financial emergencies, and that nearly 25 percent periodically use alternative financial products from nondepository financial firms.

- KPMG LLP, the internationally respected audit, tax and advisory firm, recently reported that its latest analysis of this financially challenged market segment shows that it now includes about 88 million individuals, and an additional 6 million people may join these ranks in the next two years. This report also “indicates that the underserved market is growing quickly because millions of wage-earning adults are unfortunately moving from the ‘average’ credit score to the ‘damaged’ credit score due to negative events . . . .”

- FICO credit scores of 24.9 percent of all U.S. consumers are below 600, a level where it is very difficult, if not impossible, for most to obtain unsecured personal loans from traditional banking institutions. Of particular note is the fact that many middle-class consumers’ credit ratings have deteriorated and, like many with lower incomes, they cannot qualify for bank loans.

- A new 2011 study released by the National Bureau of Economic Research (NBER) also presents a disturbing picture of many American households’ “financial fragility.” This study found that almost half of all households, including a sizable portion of solidly middle-class families, reported that they could “probably not” or “certainly not” come up with just $2,000 to deal with an ordinary financial shock of that size, even if given 30 days to do so. The findings were not unique to low-income populations. Roughly 38 percent of households with an annual income over $100,000 said they would not be able to cope with such an expense.

- Another report from the National Foundation for Credit Counseling (NFCC) concluded that to pay for an unplanned expense of $1,000, instead of being able to rely on savings, 64 percent of Americans would have to seek out credit elsewhere, such as borrowing from friends or family, securing a cash advance on credit cards, selling or pawning their personal possessions or taking out payday loans.

---


10 Id.


12 Id.


15 Id.
assets, securing a small loan from a nondepository financial institution, or disregarding other monthly expenses.  

These needs have been further exacerbated by recent federal financial services regulations, such as the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Such regulatory measures have led banks to increase fees and qualification requirements for their services, pushing many financially challenged consumers out of traditional financial institutions, and new restrictions on other forms of credit have further constricted the marketplace. Indeed, the amount of consumer credit available to Americans in 2010 had decreased to $433 billion from $887 billion in 2007.

The perspectives of payday lenders—through day-to-day experiences serving customers—confirm that a large segment of American households are indeed “financially fragile,” living at the margin of their disposable incomes. These consumers periodically need short-term, small loans to cope with unexpected or unplanned expenses. These expenses typically involve medical bills, home and automobile repairs, as well as basic household costs such as utility and credit card bills, and avoiding costly consequences of missing bill payments, including fees associated with reconnecting utilities and checking account overdrafts or late payments on credit cards. Consumers in these situations seek viable avenues for overcoming their financial shortfalls and avoiding related punitive consequences, and may consider such services as small-dollar bank and credit union loans when available, overdraft programs, credit cards, cash advances, pawn and car title loans.

Financially Challenged Consumers’ Credit Choices

Availability of Small, Short-Term Personal Loans from Traditional Banks

Before discussing payday advances and other alternative credit options, attention will be given in this article to what choices financially challenged consumers have for obtaining small unsecured personal loans from traditional banks.

When a financially challenged consumer who has an established relationship with a bank, such as a checking or savings account, needs to obtain such a loan, logically they might seek to obtain

it from their bank. What loan choices will the bank most likely offer? The short answer in most cases appears to be “none.”

Saying this is not meant as a criticism of banks because there appear to be understandable and legitimate business reasons for this situation.

Even when banks offer small personal loans, most financially challenged consumers cannot qualify for them. This fact was noted recently in an article by Kelly Edmiston, a Federal Reserve Bank of Kansas City senior economist:

Clearly, if access to a traditional lender such as a bank is available, most would-be payday borrowers would be better off seeking short-term funds there. But few banks make small-dollar loans. Even if they did, few typical payday loan borrowers would have sufficient credit standing to acquire such a loan.

For a number of years, banks and credit unions have met their customers’ needs for short-term credit through services such as overdraft protection, non-sufficient funds (NSF) transactions and credit cards. In fact, credit cards and other revolving debt plans offered by banking institutions amount to $617.7 billion outstanding in the U.S. as of June 20, 2011 and now account for by far the largest share of unsecured consumer lending. However, many federally insured depositories have been reluctant to enter the small personal loan market. In particular, the majority of banks do not make small loans (e.g., $300-$500) to higher-risk consumers because banks’ operating costs tend to be relatively high, and it is very difficult for most to make such loans on a profitable, economically viable basis unless high rates are charged. Charging high rates exposes banks to unwanted reputational risks, as critics would make similar arguments against such services as those made against traditional payday loans. Banks and credit unions that offer short-term, cash advance services that are similar to traditional payday loans generally charge relatively high fees and come with a number of additional limitations and requirements (e.g., direct deposit of customers’ paychecks to ensure prompt repayment) that consumers may

---


22 Wides, supra note 16, at 2.


24 See G. MICHAEL FLORES, BRETTON-WOODS, INC., 2009 FEE ANALYSIS OF BANK AND CREDIT UNION NON-SUFFICIENT FUNDS AND OVERDRAFT PROTECTION PROGRAMS 15 (2010), available at http://bretton-woods.com/media/3dba14ccfd97117ffff82a5fffd523.pdf. Flores notes: “Most banks are unlikely to meet this unmet credit demand due to their cost structure to underwrite individual small credits. Because of these constraints, many banks do not underwrite individual credits under $5,000 and many will not offer individually underwritten unsecured loans to customers.” Id. at 15.
find unattractive. Critics of payday lending often attack such bank products as being too costly.

Banks and credit unions continue to provide overdraft services as their primary short-term credit offering. While such overdraft programs generally are quite profitable for depositories, they frequently are far more costly to consumers than payday advances. This has been well documented in the FDIC’s Study of Bank Overdraft Programs. This FDIC study showed, among other things, that the median overdraft was $36, but the median fee to cover overdrafts was $27. This has been further illustrated by a 2011 study conducted by the Consumer Federation of America which found that overdraft fees of the fourteen largest U.S. banks when expressed in APR terms ranged from 884% to 3250%.

The FDIC overdraft study also reported that a “significant share of banks (24.7 percent of all surveyed banks and 53.7 percent of large banks) batch processed overdraft transactions by size, from largest to smallest, which can increase the number of overdrafts.” Moreover, a number of customers were heavy repeat users of overdraft protection services. Customers with five or more NSF transactions accrued 93.4 percent of the total reported NSF fees, those with 10 or more accrued 84 percent of these fees, and those with 20 or more NSF transactions accrued over 68 percent of the reported fees.

An analysis conducted by Pew Health Group’s Safe Checking in the Electronic Age Project of more than 250 checking accounts offered online by the 10 largest banks in the U.S. shared similar findings. According to Pew, the median overdraft penalty fee associated with these accounts was $35; if applied to the median overdraft amount of $36 identified by the FDIC “with a repayment period of seven days, the APR, or annual percentage rate, on the typical overdraft would be over 5,000 percent—a costly way to address credit needs.” Pew’s analysis also found that banks typically cap the number of overdrafts per day that a customer may incur, but given

---

28 Id. at iii.
31 Id. at iv.
the range of caps in place at major banks, customers could still be charged $140 or more per day in overdraft fees. 33

Furthermore, an analysis by Bretton Woods, Inc., a financial services consulting firm, found that NSF and overdraft fees charged by banks and credit unions in 2009 exceeded $38 billion and had been “the single greatest component of bank and credit union profitability for the past several years,” with such programs generating an estimated 74 percent of banks’ service charge income, and 80 percent of credit unions’ fee income. 34 This study found that the average U.S. household with a banking account incurred approximately 13 NSF and overdraft fees in 2009 with an annual cost per household of $376. But the 20 million households that are particularly active users of these services paid an average of $1,504 annually. 35

Federal banking regulators have sought to limit banking institutions’ overdraft charges, and regulatory changes adopted in 2010 required consumers to opt-in to certain types of bank overdraft programs. 36 Moebis Services, Inc., an economic research firm that conducts periodic studies of overdraft fees, recently reported that despite federal regulators’ efforts to curtail fee-based overdraft programs, which in 2010 had resulted in a decline in consumer usage of overdrafts, the recent trend has been a pronounced shift back to such programs as more consumers (77 percent of more than 130 million checking accounts) have voluntarily opted-in to use this convenient but expensive credit service. 37

The FDIC’s Small-Dollar Loan Pilot Program

Federal regulators also have sought to encourage federally insured banks to offer short-term, small-dollar loans that can be an alternative, less expensive option to traditional payday loans for financially challenged consumers. The FDIC has been especially active in this regard and began a two-year pilot program in early 2008 that was intended to show “how banks can profitably offer affordable small-dollar loans as an alternative to high-cost credit products, such as payday loans and fee-based overdraft protection.” 38 Loans in this program included what the FDIC categorized as “small-dollar loans” (SDLs) of $1,000 or less, and “nearly small-dollar loans” (NSDLs) between $1,000 and $2,500. SDLs averaged approximately $700, or about twice the size of a typical payday advance, and NSDLs averaged approximately $1,700. 39 Initially, 31

33 Id.
34 Flores, supra note 20, at 11.
35 Id. at 4.
36 Effective July 1, 2010, Regulation E required that bank and credit union customers to opt-in to authorize debit card overdrafts. No opt-in is required in ATM transactions as long as the ATM displays a notice allowing the consumer to opt-out of the transaction if it would incur an overdraft fee. 12 C.F.R. § 205.17 (2010).
39 Id. at 30.
banks participated in the program, and 28 were in this pilot project when it concluded in the fourth quarter of 2009.\textsuperscript{40} During the two-year pilot, only 18,163 SDLs totaling $12.4 million, and 16,294 NSDLs totaling $27.8 million, were originated.\textsuperscript{41} Although delinquency ratios for both loan categories were “much higher than for general unsecured” loans to individuals, the FDIC reported that charge-off ratios were “in line with the industry average.”\textsuperscript{42}

Based on the experience gained in this pilot effort, the FDIC put forth a so-called “template” to demonstrate how other banks might design and deliver products such as those offered during the pilot program.\textsuperscript{43} This template is as follows:

\begin{table}[h]
\centering
\begin{tabular}{|l|l|}
\hline
Product Element & Parameters \\
\hline
Amount & $2,500 or less \\
Term & 90 days or more \\
Annual Percentage Rate (APR) & 36 percent or less \\
Fees & Low or none; origination and other upfront fees plus interest charged equate to APR of 36 percent or less \\
Underwriting & Streamlined with proof of identity, address, and income, and a credit report to determine loan amount and repayment ability; loan decision within 24 hours \\
Optional Features & Mandatory savings and financial education \\
\hline
\end{tabular}
\caption{A Safe, Affordable, and Feasible Template for Small-Dollar Loans}
\end{table}

It should be noted that this small-dollar loan template is called “feasible,” rather than “profitable.” While the FDIC has proclaimed the success of this pilot program, the agency’s analysis of the program’s outcome essentially acknowledges that the small-dollar loans offered were not shown to be profitable in a normal commercial sense. Instead, these were touted as “a useful business strategy for developing or retaining long-term-relationships with customers” and a means “to cross-sell additional products.”\textsuperscript{44} The FDIC reported:

Program and product profitability calculation are not standardized and are not tracked through regulatory reporting. Profitability assessments can be highly

\textsuperscript{40}Id. at 29
\textsuperscript{41}Id. at 29-30.
\textsuperscript{42}Id. at 30-32.
\textsuperscript{43}Id. at 28.
\textsuperscript{44}Id. at 32. Participating banks also may have benefited from what may be termed “regulatory goodwill” for offering smaller loans and also from favorable Community Reinvestment Act consideration.
subjective, depending on a bank’s location, business model, product mix, cost and revenue allocation philosophies, and many other factors. Moreover, many of the banks in the pilot are community banks that indicated they either cannot or choose not to expend the resources to track profitability at the product and program level.

Nevertheless, as a general guideline, pilot bankers indicated that costs related to launching and marketing small-dollar loan programs and originating and servicing small-dollar loans are similar to other loans. However, given the small size of SDLs and to a lesser extent NSDLs, the interest and fees generated are not always sufficient to achieve robust short-term profitability. Rather, most pilot bankers sought to generate long-term profitability through volume and by using small-dollar loans to cross-sell additional products.45

The FDIC is to be commended for seeking to promote lower-cost small-dollar loans. However, one must question whether most bankers will adopt the FDIC’s view of profitability and be willing to offer such loans under the terms of the “Feasibility” template, and on a scale large enough to meet the credit needs of the extremely large financially challenged market.46 When considering the safety and soundness implications of banks’ utilizing the template on a large scale, it would seem very challenging, to say the least, to follow this model.

In any case, payday lenders like Advance America, whose cost structures typically are significantly lower than federally insured banks, have found it impossible to profitably make small cash advance loans under a 36 percent APR cap as the FDIC advocates. For example, under a 36 percent APR cap, a typical payday advance of $300 would yield a total fee of $4.14. It would appear that no lender—not a credit union, not a bank, and not a payday lender—can make such loans to many customers for less than 30 cents a day without subsidization or ceasing operations because of the losses incurred on such loans. The following chart illustrates how a lender would lose money under a 36 percent APR cap (which means a lender could only charge a fee of $1.38 on a $100 two-week cash advance), considering only a modest level of loan losses and without any provision for operating expenses:

45 Id.
46 Organizations representing the cash advance industry have found considerable fault with the FDIC’s claimed successes under the pilot program. See, e.g., FIN. SERV. CTRS. OF AMERICA, INC., THE FDIC SMALL DOLLAR LOAN PILOT PROGRAM: A CASE STUDY OF A MISGUIDED APPROACH TO SATISFYING CONSUMERS’ NEED FOR SMALL DOLLAR CREDIT (2009), available at http://www.rtoonline.com/images/fdicsdlcritique.pdf.
Payday lenders have experienced these economic realities in states where such caps have been imposed, as they have not been able to cover the cost of basic operating expenses, such as wages, rent and utilities, let alone the costs of loan losses. This is precisely why industry opponents have advocated a 36 percent APR cap on payday loans—they understand that it is in effect a loan prohibition. For example, a representative of the Center for Responsible Lending, which has led a campaign to prohibit payday lending in various states, said that when Ohio policy makers passed a 28 percent APR cap several years ago they “fully understood that [an APR cap] would ban the product . . . . And I think, frankly, that was the intent.”\(^{47}\) Lenders in states that have imposed such caps have been forced to close hundreds of loan centers, costing thousands of employees their jobs and leaving consumers with fewer, and in many cases far more expensive, credit choices. Indeed, according to an Urban Institute study conducted for the Treasury Department, prohibiting payday loans is associated with just a 35 percent decline in the use of payday loans; in states that have implemented such measures, consumers instead use costlier, less regulated loans, such as Internet payday loans, or travel across state lines to obtain short-term credit.\(^{48}\)

It would reasonable to conclude that this harsh economic reality is why, two years after the pilot program began, the number of banks offering such loans apparently has not expanded. At a September 2011 hearing before the House Financial Institutions and Consumer Credit Subcommittee, the FDIC’s Deputy Director of Consumer Protection and Community Affairs, Robert Mooney, said that 26 of the 28 banks participating in this FDIC Pilot continue to offer the


\(^{48}\) SIGNE-MARY MCKERNAN, CAROLINE RATCLIFFE & DANIEL KUEHN, URBAN INSTITUTE, PROHIBITIONS, PRICE CAPS, AND DISCLOSURES: A LOOK AT STATE POLICIES AND ALTERNATIVE FINANCIAL PRODUCT USE 22 (Nov. 2010), available at [http://www.urban.org/publications/412306.html](http://www.urban.org/publications/412306.html); see also JEAN ANN FOX & ANNA PETRINI, CONSUMER FED. OF AMERICA, HOW HIGH-PRICED LENDERS USE THE INTERNET TO MIRE BORROWERS IN DEBT AND EVADE STATE CONSUMER PROTECTIONS: A CFA SURVEY OF INTERNET PAYDAY LOAN SITES (Nov. 2004).
loans today. But he did not identify any instances in which the lending was profitable, nor did he report that other banks are offering small loans based on the “Feasibility” template. Rather, he said that the program allowed participating banks to develop long-term customer relationships, and commented in oral remarks during the hearing that this was “the primary reason they engaged in the program.”

It stands to reason, though it seems hard for industry critics to acknowledge, that if such loans could be offered at a profit, more banks would already be doing so—thus increasing competition with nondepository lenders for financially challenged consumers’ short-term, small-dollar loan business. In reality, while investing in relationships by offering unprofitable loans may be justified in some instances, this does not appear to be a viable strategy for effectively meeting the needs of the tens of millions of financially fragile consumers.

Credit unions have also begun offering more short-term credit options to their members. More than 500 credit unions across the country offer such loans, which often are labeled as payday advance alternatives, and in some cases specifically are termed payday loans. Administrators of these programs often claim that they are less-expensive than traditional payday loans, based on the comparative APRs of the services. However, while credit unions may disclose a seemingly low APR, their loans often involve additional membership, application and loan origination fees that are frequently hidden in the fine print of their loan agreements. In one such example, a major credit union advertises a 15 percent APR on its small-dollar, short-term loans, but these loans also involve a $39.95 application fee and a $10 annual membership fee, which when included in the calculation result in an APR of over 350%. And, it should be noted that, as with banks, credit unions’ main short-term credit offering is higher-cost overdraft services, which generally involve a $25 fee per overdraft, according to Moebs. Consumer advocates have not necessarily supported all of these credit union programs.

The following chart shows the costs associated with comparable loan products:

---

49 Mooney, supra note 20, at 6. Elsewhere the FDIC has said that 31 banks participated in this program and 28 remained at the end. FDIC Pilot, supra note 35, at 29.
52 Id.
54 Id.
55 Moebs, supra note 37.
From the perspective of payday lenders, there is no objection to innovative private sector programs that can provide consumers with lower cost products through banks or other lenders to help meet their short-term, small-dollar credit needs. Nor is there objection to government agencies like the FDIC encouraging such programs, provided certain lenders’ products are not subsidized by taxpayer dollars. Such an arrangement would result in unfair competition with lenders that did not benefit from similar subsidies. Consumers thrive in a competitive, regulated financial services environment. But comparable short-term credit options ought to be governed by similar regulations, including uniform disclosure requirements, to ensure that consumers are equipped with all of the information they need to compare services. Such an approach would provide equitable treatment for lenders without limiting valuable consumer choices.

**The Payday Loan Option**

Although some banks and credit unions continue to explore ways to offer lower cost, small-dollar credit products to financially challenged consumers, Advance America sees no convincing evidence that such efforts can be expected to help more than a very small percentage of consumers who have urgent credit needs today, tomorrow and for the foreseeable future.  

---


58 Similarly, while credit counseling, consumer financial education, savings and always handling personal financial matters in responsible manner should be strongly encouraged, it would seem unrealistic to expect that most financially challenged consumers’ credit needs will be ended by such initiatives.
Therefore, public policy attention should be directed toward further evaluating alternative, credit choices available to these higher credit risk consumers. Advance America believes that a more realistic and objective analysis than has heretofore been made by industry critics and some government officials shows that payday loans provided by regulated lenders are a sensible and effective means for many consumers to handle their short-term, small-dollar credit needs.

Data shows that payday advances are often the less-costly credit alternative, and they provide financially challenged consumers with a valuable financial management tool to avoid experiencing worse financial problems, including facing the costs and penalties of missing bill payments or submitting them late or resorting to unregulated loans.\textsuperscript{59}

Payday advances are generally under $500, and normally due on the borrower’s next payday. The average loan is between $300 and $400, and the typical fee is $15 per $100 borrowed over an average repayment period of two to four weeks. This is a fixed, flat fee based on the total amount borrowed; interest is not compounded and late fees are not charged. Millions of consumers who are not able, or choose not to obtain credit products from banking institutions select Advance America and other regulated payday lenders to meet their periodic credit needs. They report using the service to manage short-term cash crunches such as unexpected expenses (medical costs, home or car repairs), preventing late fees on bills, avoiding bouncing checks and helping to bridge a temporary reduction in income.\textsuperscript{60}

The traditional storefront payday advance industry accounted for over 100 million loan transactions, amounting to over $29 billion in credit extended, to approximately 20 million consumers in 2010.\textsuperscript{61} Quite significantly, although payday lenders serve a broad segment of society that includes many consumers with higher incomes, the typical customer is a middle-income, working American, as illustrated by the following chart regarding Advance America’s customers:\textsuperscript{62}

\textsuperscript{59} See chart \textit{infra}, at 15.
\textsuperscript{61} STEPHENS INC., PAYDAY LOAN INDUSTRY: INDUSTRY LOOKING MORE ATTRACTIVE AS DEMAND EXPECTED TO INCREASE 1, 5, 21 (Little Rock: 2011).
\textsuperscript{62} The NBER and NCCF studies, \textit{supra} notes 14-15, pointed out how a significant segment of middle-class Americans now essentially live paycheck to paycheck and have limited abilities to meet unexpected expenses.
Advance America’s stores are located in population centers and areas where customers live, work and shop. These facilities are professional, modern and inviting and are generally found in high density retail areas within reputable shopping centers, often near large nationally-recognized anchors such as well-known supermarkets, Walmart, Radio Shack, and other chains with thousands of locations around the country.\(^{63}\) This is done for the convenience of customers, who represent a broad demographic segment and cannot be fairly grouped based on race, sex, religion or similar characteristics.

Further, payday customers are not the “unbanked,” as some critics claim, because underwriting requirements for an advance include a checking account and proof of employment or a steady source of income. Two-thirds of Advance America’s customers have at least one other financial option available to them that offers quick access to money, and approximately half have major credit cards and overdraft protection on their checking accounts.\(^{64}\)

Consumers find payday loans to be convenient and easy to understand; they know precisely what they are getting and what it is costing them.\(^{65}\) A payday loan is one of the most transparent financial products on the market. The loan terms are simple and the fee is fully and prominently disclosed both as an implied APR and as a dollar amount. Not surprisingly, according to Advance America’s surveys and data, over 97 percent of customers are satisfied with the company’s services.\(^{66}\) Our state regulators report very few customer complaints (less than 50 such complaints were filed with regulators out of over 10 million transactions in 2010).\(^{67}\) Repayment statistics demonstrate the affordability of payday loans, as more than 90 percent of

---

\(^{63}\) *You Might Be Surprised What You Learn,* ADVANCE AMERICA, [http://www.advanceamerica.net/surprised/about](http://www.advanceamerica.net/surprised/about).

\(^{64}\) Advance America corporate data.

\(^{65}\) The application process for a payday advance is straightforward and transparent: the customer visits a lender center, provides identification, proof of employment and a bank statement, completes an application form, signs a credit agreement, writes a check to the lender for the amount of the loan and fee, makes an appointment to return and repay the advance, receives their cash or check advance, and returns on the appointment date to repay the loan on their next payday (usually in two to four weeks) and reclaims their check or may simply have the check deposited.

\(^{66}\) Advance America, *supra* note 63.

\(^{67}\) Advance America corporate data.
customers repay their loans on time.68 Payday advances sometimes are mistaken for other forms of short-term credit, but these services are distinct. For example, car title or pawn shop loans require collateral or personal property as security. Consumer installment loans offered by nondepository lenders and, when available, by some insured depositories typically involve larger dollar amounts and lengthier repayment periods than payday advances, resulting in a higher debt obligation and a longer-term commitment for consumers. In addition, regulated payday lenders offer customers less-costly loans than unregulated Internet lenders, and extend more consumer safeguards.69

The domestic cash advance industry is subject to both state and federal regulation.70 Payday advances are currently allowed under the laws of thirty-one states.71 State laws typically limit the principal amount of an advance, set maximum fees, provide for minimum and maximum loan terms, limit a customer’s ability to renew an advance, allow customers the right to rescind the transaction before the end of the next business day, and require various disclosures. Laws in many jurisdictions, as well as payday advance industry’s self-imposed policies, give borrowers the right to repay their loan over an extended period of time, without incurring additional fees, if they cannot pay as initially promised. To enforce these provisions, state regulators generally require lenders to meet specified licensing requirements, file periodic written reports on business operations, and undergo state audits and exams to ensure compliance with applicable laws. States regulators also impose fines or other penalties on payday lenders for failure to comply with such laws. Additionally, lenders like Advance America do not pursue criminal prosecution if a loan is not repaid, and consumers’ credit ratings are not harmed if they are unable to pay as agreed.

Weighing All Options

When financially challenged consumers are faced with periodic unexpected or unplanned expenses—as everyone certainly is—many first consider whether or not to obtain credit at all. As

---

71 Advance America is a founding member of the Community Financial Services Association (CFSA), which is the payday advance industry’s leading trade group. CFSA has taken a lead in advocating responsible state legislation to regulate the industry and has also adopted a mandatory set of Best Practices that must be followed by its members. Many of these Best Practices requirements exceed what is required in some states’ laws. Among other things, it requires that CFSA members offer customers who are unable to pay their loan on time an extended payment plan that allows the loan to be repaid through a series of smaller installments. CFSA’s Best Practices are available at http://cfsaa.com/cfsa-member-best-practices.aspx.
part of this deliberation, they weigh the consequences of disregarding their financial obligations, which can be catastrophic. Those who do so can find that:

[Their immediate financial problem can] easily snowball out of control and have serious consequences. Skipping the rent or mortgage payment, and neglecting to pay credit cards or loans will cause late fees to be added to the debt, putting negative marks on the credit report, resulting in a lower credit score, well-meaning individuals who are already living on the financial edge may never be able to catch up, exacerbating the problem for months or years down the road.\footnote{NFCC, \textit{supra} note 15.}

Most of these consumers ultimately decide obtaining credit is the preferable option, and seek to cope with their financial shortfalls through an alternative credit product.\footnote{The term “alternative credit product” as used in this article refers to credit products other than unsecured small personal loans offered by insured depository institutions, and includes products offered by nondepository financial services providers (such as small installment loans, payday loans and pawn and title loans) and fee-based products and services offered by depositories (such as overdraft protection and credit card advances).} Certainly, payday loans are not their only option. A range of credit options are available in today’s marketplace and this variety of products is appropriate.

Different alternatives appeal to these consumers for a variety of reasons, and no single credit option is always the best in every circumstance. Some may be able to borrow from family or friends, but not everyone has this option, and many who do elect not to take it because they are embarrassed to do so. A relative few may be able to get a suitable small personal loan from a bank or credit union. Others may qualify for a somewhat larger, longer-term loan from a finance company or installment lender, though such credit can expose them to a higher level of debt and will likely involve significantly higher rates than those offered to low-risk, more affluent customers.

In Advance America’s experience, our customers typically weigh their credit options and select their lower cost alternatives. Others do not and simply select what they deem to be the most convenient irrespective of the cost involved. For example, millions of consumers utilize fee-based bank and credit union overdraft protection programs extensively. Their check is covered and the credit extension is made quite conveniently, but the fee for doing so is generally significantly more costly than a payday loan.\footnote{See CFA, \textit{supra} note 25.} Consumers who do compare the costs, as well as the convenience, of their options will find that obtaining a payday advance from a regulated lender is not only convenient, but often considerably less expensive than many competing alternatives, such as overdraft fees, credit card late fees, utility reconnect fees, and NSF and merchant bad-check fees. The following chart illustrates the relative costs of these alternatives:
Given the costs of the likely available options, it is not surprising that millions of consumers choose payday loans to help them address their pressing credit needs. Advance America’s belief, based on its extensive experience with its customers, is that most select a cash advance because it is less costly than their other likely available options, and they consider it affordable, and most suited to their needs. This is especially true when customers need cash quickly to avoid high NSF, overdraft and credit card late fees, but it also applies in numerous other situations. Customers also often are influenced to some extent by other factors such as the convenience of being able to obtain a loan promptly in an attractive location, on very understandable terms, with limited simple paperwork, and during hours when other credit sources may not be available. In short, while a payday loan is not the best option for the consumer in some cases, in many others it is, and millions of consumers select it.

**Critics’ Favorite Attack: “Outrageous” Interest Rates and Excessive Profits**

Much of the concern over payday advances has been based on consumer advocacy groups’ inflammatory allegations that payday lenders are charging customers exorbitant interest rates which cause many people to believe lenders are making excessive profits. From the perspective of the payday lending industry, those who make such claims seriously mislead the public, and frequently do so intentionally. Payday advance lenders have no doubt that their most vocal critics know that the fees charged for small, short-term cash advances are reasonably priced and are not generating extreme profits. However, these critics continuously allege lenders are charging outrageous rates, focusing on the implied annual percentage rate disclosed by lenders,
typically a triple-digit number. Such an approach advances their political agenda, but misleads many people to immediately think unconscionable fees are being charged.\(^75\)

The misconception stems from a widespread misunderstanding of how the fee charged for a payday advance translates into an APR. The typical one-time, flat fee for a payday advance is $15 per $100 borrowed for a two-week period, which in most cases is the time between customers’ paychecks. The total amount a customer will repay for such a loan is $115; they will not pay any interest.

In other words, the stated APR of 391 percent for a two-week payday advance is not an accurate representation of the cost of an advance. It is an implied, theoretical annual rate for an advance, and assumes that payday advances are extended 26 times (every two weeks) during a year, with the customer paying a new fee each time.

| $15 | Typical Advance Fee (per $100 Borrowed) \(\times\) 26 | of Consecutive 14-day Pay Cycles | =391% Implied APR |

This is a flawed assumption. Consumers generally utilize the service for a relatively short period of time—weeks or months, not years. Furthermore, virtually all state laws prohibit loans from being extended 26 times; in fact, such rollovers typically are either prohibited or limited by law to one or two times. Clearly, APR is a more suitable cost measurement of longer-term loans, such as mortgages or student loans, and can only be used accurately to compare loans of the same or similar duration.

Critics describe the loan cost in terms of an APR, which clearly distorts the true cost of a payday loan, because it makes it appear that the lender is charging an actual interest rate of 391 percent or more of the amount borrowed.\(^76\) The quick (but quite incorrect) math for many people who are unfamiliar with payday loans and APR calculations is that for a $100 loan for two-weeks, a payday lender would charge about $400. If this was true, the fee would be totally unjustifiable and clearly unconscionable. Of course, this is not the case.

The fact that the APR is not an accurate measurement of the cost of short-term credit is widely recognized in the financial services industry. For example, in testimony given in a hearing before the Subcommittee on Financial Institutions and Consumer Credit of the U.S. House of Representatives’ Financial Services Committee, witnesses from the American Bankers

\(^75\) Many in the consumer finance industry suspect that the real goal of many advocacy groups that attack payday loans (and often other short-term, small-dollar credit products) is to so limit the availability of such products that Congress can be forced to pass some type of credit subsidy plan to enable certain lenders (e.g., credit unions) to offer below market rate loans on a mass basis to financially challenged consumers because so many millions of these voters will be desperate for credit availability.

\(^76\) An APR calculation can provide a useful comparison tool when evaluating the cost (fees, interest and other charges) of longer-term loans like home mortgages, but Advance America believes that they are extremely misleading when used for short-term, small-dollar loans.
Association (ABA), the Credit Union National Association and the Independent Community Bankers of America, all noted this fact.\textsuperscript{77} The ABA testimony, for example, explained:

Any time an annual percentage rate is calculated for a term less than a year, the inclusion of a fixed fee, even a modest one, will distort and overstate the APR. The shorter the repayment period, the greater the APR will appear in instances where there is a fixed fee. This means that the sooner the consumer repays, the greater the calculated APR—a difficult concept to explain to consumers, as it appears that paying earlier actually increases the cost of credit.\textsuperscript{78}

The following chart illustrates how the same fee of $15 for a payday advance gives a dramatically different APR as the loan term changes:

It should be noted that while describing payday advance costs in APR terms is politically advantageous to industry critics, these figures are not very helpful to most customers, who find disclosure of the fee as a dollar amount to be much clearer than the confusing, “make-believe” APR figure.\textsuperscript{79}


\textsuperscript{78} Id. at 22 (statement of Kenneth J. Clayton), available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/clayton031909.pdf.

\textsuperscript{79} See Edmiston, supra note 17, at 65; see also Thomas A. Durkin, Should Consumer Disclosures Be Updated?, UCC08-10 (Harv. Jt. Ctr. for Housing Studies, 2008) (discussing history and issues regarding APR calculations), available at http://www.jchs.harvard.edu/publications/finance/understanding_consumer_credit/papers/ucc08-10_durkin.pdf.
In summary with respect to rates charged by payday lenders, Advance America feels that critics’ emphasis on the implied APR rates of cash advances is quite misleading. It usually causes those who do not use payday loans and who have little understanding of how such APRs are calculated to believe that consumers are being charged incredibly and unjustifiably high actual interest rates. This in turn results in many jumping to the incorrect conclusion that lenders are making excessive profits. On the other hand, consumers who use payday loans understand the cost of the loan in terms of the actual fee charged (even though many appear to be confused by and disregard the APR disclosure), and payday lenders hear no outcry from customers themselves that lenders are making unreasonable profits.

Specifically with regard to payday advance lenders’ profits, Advance America’s data illustrate that it makes only reasonable profits, which actually are considerably lower than many other businesses. The company’s one-time fees for its cash advances are priced to provide a fair profit after covering the costs of operating more than 2,300 brick-and-mortar loan centers, as well as company overhead expenses, and the cost of loan losses that occur when some individuals do not repay their loans as agreed. The following charts demonstrate that Advance America’s profits are clearly reasonable and are well below those of many other corporations:

---

80 While Advance America believes that using APRs for short-term credit products is inappropriate, to the extent that an APR calculation is required on any such product, it should be required on all such products and should be calculated so as to include all credit costs. Currently, this is not the case. Banks and credit unions, for example, are not required to disclose the cost of their fee-based overdrafts in APR terms. Similarly, as more credit unions are offering payday loan like products they are able to use an understated APR disclosure, which does not include significant fees, that makes it appear their loans are much less expensive than is in fact the case. It would be far clearer to consumers, and fairer for competing financial services providers, if the total credit costs, including all interest and fees, were required to be disclosed as a total dollar amount and as a percentage of the total amount of credit extended.
# Cost Per $100 Loan Analysis

<table>
<thead>
<tr>
<th></th>
<th>Per $100 Loan</th>
<th>% of Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$16.00</td>
<td></td>
</tr>
<tr>
<td>Loss rate @ 18.6%</td>
<td>2.98</td>
<td>18.6%</td>
</tr>
<tr>
<td>Store operating expenses</td>
<td>9.09</td>
<td>56.8%</td>
</tr>
<tr>
<td>Corporate expenses &amp; other</td>
<td>1.73</td>
<td>10.8%</td>
</tr>
<tr>
<td>Interest expense</td>
<td>0.13</td>
<td>0.8%</td>
</tr>
<tr>
<td>Profit</td>
<td>$2.08</td>
<td>13.0%</td>
</tr>
<tr>
<td>Total cost</td>
<td>$13.92</td>
<td></td>
</tr>
</tbody>
</table>

Source: AEA Company documents, Stephens Inc.

*Loss rate cited is national average loss rate for public payday lending companies.

---

## Historical Cost Per $100 loan

<table>
<thead>
<tr>
<th></th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$16.16</td>
<td>$15.11</td>
<td>$15.66</td>
<td>$15.92</td>
<td>$16.00</td>
</tr>
<tr>
<td>Loss Rate*</td>
<td>3.36</td>
<td>3.85</td>
<td>3.63</td>
<td>3.25</td>
<td>2.98</td>
</tr>
<tr>
<td>Store operating expenses</td>
<td>8.77</td>
<td>9.07</td>
<td>8.87</td>
<td>8.87</td>
<td>9.09</td>
</tr>
<tr>
<td>Corporate expenses &amp; other</td>
<td>1.37</td>
<td>1.42</td>
<td>1.70</td>
<td>1.46</td>
<td>1.73</td>
</tr>
<tr>
<td>Interest expense</td>
<td>0.16</td>
<td>0.24</td>
<td>0.26</td>
<td>0.15</td>
<td>0.13</td>
</tr>
<tr>
<td>Profit</td>
<td>$2.50</td>
<td>$1.52</td>
<td>$1.20</td>
<td>$2.19</td>
<td>$2.08</td>
</tr>
</tbody>
</table>

*Loss rate is the storefront industry average for each year.

Source: Company filings, Stephens Inc. estimates
In addition to industry data such as that presented above, third-party studies have confirmed that payday lenders are not making excessive profits by charging unfair fees.  

This study finds that the industry’s proffered justifications for high service fees, and by extension high APRs, may be justified by both high store expenses and high loan losses. In addition, this study finds that payday lender profit margins are less than half that of their mainstream lending counterparts. 

These figures indicate that payday lenders are not overly profitable organizations. Contrary to conventional wisdom, these firms fall far short of profits for mainstream commercial lenders.

It also is quite informative to consider the rate and profit issue in the context of the 36 percent APR rate cap favored by industry critics and the FDIC. This has been done by Stephens Inc., an independent investment banking firm, as a part of its June 6, 2011 detailed analysis of the payday loan industry. Stephens gives the following analysis using Advance America (AEA) data:


Id.
We looked at AEA’s cost structure as a proxy for the industry. AEA’s store operating expenses, excluding loan loss provisions, were approximately $138,000 per average store in FY10. In addition, its corporate overhead and interest expense per average store were about $26,000 and $1,900, respectively, for the year. When adding all the costs together and dividing by 12, the average monthly cost to operate a store is around $13,825, which does not include loan losses. Therefore, if losses were zero and assuming the average loan size at $350, AEA would need to make approximately 3,150 loans a month just to break even at 36 percent APR. For the entire year of 2010, the average AEA store wrote about 4,060 loans, or about 338 per month.

Our point of this exercise is to show that at 36 percent APR, it is basically impossible for a storefront lender to make money offering small dollar loans. Storefronts are there for the customer’s convenience, but there are significant costs involved. We could include banks in this discussion as well because they would need to cover branch expenses. The reason the payday loan industry originated to begin with was due to traditional banks not making small loans to consumers because it became unprofitable.84

“Cycle of Debt” or “Important Debt Management Tool”?85

The second overarching contention of the payday lending industry’s critics is that payday advances cause consumers to sink into a “cycle of debt” whereby they fall increasingly and hopelessly behind in their financial obligations. In essence, they argue that financially challenged borrowers would be much better off in dealing with their periodic short-term credit needs if payday loans were prohibited.

Feedback from Advance America customers and supporting data undermines this viewpoint, showing that it is not only wrong-headed, it is patently contrary to reality, common sense and consumers’ best interests. Although some borrowers use payday loans irresponsibly, just as some do with credit cards, overdrafts and other credit products, the overwhelming majority of cash advance customers use their loans responsibly to manage their financial obligations. Advance America customers report high levels of satisfaction—recent customer feedback surveys found that more than 90 percent of customers rated the service as good or excellent and 93 percent said they would consider Advance America in the future. Further, among more than 10 million transactions nationwide, fewer than 50 Advance America customers filed complaints with state agencies in 2010.86

84 Stephens, supra note 44, at 23.
86 Advance America corporate data.
87 Id.
These customers’ credit needs are immediate, and cannot wait for the development of other low-cost credit options at some later point—these consumers need credit, and they need it today. It must also be recognized that their need for supplemental credit is often not an isolated occurrence. In many instances, they will need to utilize payday loans or other small, short-term credit options periodically over a number of months to manage their finances as different needs arise. Thus, the present concern and focus should be on ensuring they have access to as many regulated options for managing their financial difficulties as possible, including payday loans. As has been noted, traditional banks typically do not offer such consumers affordable unsecured small personal loans. In addition, the degree to which credit unions will be able to offer lower-cost, alternative payday loan products is uncertain and in any case such loans would not be available to the millions of consumers who are not credit union members. And, while many parties, including payday lenders, are seeking to find ways to lower loan costs and to develop innovative credit products, there is no known realistic immediate or near-term scenario where significantly less-expensive new products will be available on a large-scale, commercially viable basis. Indeed, a staff report from the Federal Reserve Bank of New York found that “banning payday loans is not, by itself, going to motivate competitors to lower prices or invent new products.” Likewise, while credit counseling and consumer financial education efforts can be helpful and should be encouraged, consumer behavior on financial matters cannot reasonably be expected to change significantly enough in the immediate or near-term to help but a small fraction of financially challenged consumers secure significantly less costly credit.

In this environment, Advance America and other regulated payday lenders provide millions of consumers with a valuable option—a product that is widely accessible, transparent, affordable and significantly less costly than the primary alternatives (e.g., overdrafts, NSF and bad-check fees, credit card advances or late fees). These are key reasons why consumers choose payday advances, and not other less-preferable and more costly alternative. One such less favorable option, which consumers with limited credit choices are selecting more and more is to obtain loans from unregulated offshore Internet lenders who charge far higher fees than traditional

---

88 See Stango, supra note 21.
89 DONALD MORGAN & MICHAEL R. STRAIN, FED. RESERVE BANK OF N.Y., STAFF REPORT NO. 309, PAYDAY HOLIDAY: HOW HOUSEHOLDS FARE AFTER PAYDAY CREDIT BANS 27 (2008), available at http://www.newyorkfed.org/research/staff_reports/sr309.pdf. This study concluded: “While our findings contradict the debt trap/addiction hypothesis against payday lending, they are consistent with alternative hypothesis that payday credit is cheaper than the bounce ‘protection’ that earns millions for credit unions and banks.” (footnote omitted), Id. at 26.
90 When payday loans are not available, some consumers in certain instances will be able to find a relatively inexpensive option (e.g., a low- or no-cost small loan from a friend or family member), but in the vast majority of cases the financially challenged consumer will be forced to choose a credit option that is more costly than a payday loan and therefore more likely to make his or her debt problems worse than would have been the case if the payday loan had been available.
payday lenders. These foreign lenders operate illegally without complying with state and federal consumer protection laws that are followed by legitimate domestic regulated payday lenders.\textsuperscript{91}

The arguments of those who would “protect” financially challenged consumers by denying them access to less-costly payday loans make no sense.\textsuperscript{92} Giving consumers fewer and more expensive credit alternatives to choose from will clearly worsen their financial situation and those who are “teetering on the brink” of personal financial disaster are much more likely to be “pushed over the edge.” As Donald Morgan of the Federal Reserve Bank of New York has noted:

While our findings contradict the debt trap/addiction hypothesis against payday lending, they are consistent with alternative hypothesis that payday credit is cheaper than the bounce “protection” that earns millions for credit unions and banks. Forcing households to replace costly credit with even costlier credit is bound to make them worse off.\textsuperscript{93}

By contrast, instead of “trapping” consumers, payday loans provide most with a temporary financial helping hand that gives them a reasonable and affordable opportunity to manage a short-term cash crunch while protecting their credit standing.\textsuperscript{94}

Policymakers need to recognize this fact as the Federal Reserve Bank of New York’s Kelly Edmiston has pointed out:

Policymakers in many states have restricted the practice of payday lending. Critics of the practice claim that payday lenders take advantage of borrowers by charging exorbitant fees and targeting at-risk populations. They also claim that payday lending causes borrowers to fall into debt spirals, which create unmanageable cycles of debt.

While these charges may be valid, restricting payday lending may also bring unintended consequences. It is important for policymakers to understand both the potential benefits of restricting payday lending as well as the potential costs.

This article examined the practice of payday lending, why and how many states have restricted it, and how such restrictions might adversely affect some low-income and credit-constrained consumers. The results of its empirical analysis support the idea that restricting payday lending may indeed have costs. The evidence showed that consumers in low-income counties may have limited access to credit in the absence of payday loan options. As a result, they may be forced to seek more costly sources of credit. The


\textsuperscript{92} See Morgan, supra note 89, at 26 (footnote omitted).

\textsuperscript{93} Id. at 28.

\textsuperscript{94} Naturally, not all payday customers, despite their best efforts, will be able to overcome their financial problems, but most do although it often takes time to do so. About 90 percent repay their loans on time, but due to their continuing underlying “financial fragile” situation, for a period of time they may well need to obtain additional cash advances to meet either continuing or new expenses. Providing such cash advances is clearly more “pro-consumer” than forcing them to seek more costly credit elsewhere.
evidence also showed that, in counties without access to payday lending, consumers have a lower credit standing than consumers in counties with access.

The preponderance of evidence suggests that some consumers will likely face adverse effects if payday lending is restricted. Therefore, policymakers must carefully weigh the costs of payday lending restrictions against its benefits.95

It is also important to point out that the total annual cost for most customers using payday advances is relatively modest. A typical customer who obtains an average loan of $400 for a fee of $60 about 8 times per year will only pay $480 (on a total principal of $3,200) to meet his or her family’s year-long needs for such supplemental credit. Yet, for this modest cost, industry critics would deny customers this credit option and force them to seek more expensive alternatives that will clearly worsen their financial status.

More researchers now appear to be willing to remind critics and policymakers that the benefits of payday lending must be weighed in the ongoing public policy debate, which we believe has heretofore all too often been skewed against our industry by biased, one-sided and paternalistic arguments. Increasingly, academic experts clearly are concluding what Advance America believes is the more enlightened and correct view:

Lack of access to emergency funds can be detrimental to consumers. For instance, every bounced check can incur substantial fees and impose indirect costs. If a check is an insurance payment, the policy will be terminated; if it’s for utilities, such as telephone or electricity, it may lead to termination of service, penalties, and a substantial security deposit to reconnect service. Bouncing a check may also result in termination of a bank account and even a risk of criminal prosecution, while also damaging the individual’s credit score, making subsequent access to credit even more difficult.

Payday loan customers are not fools; they have carefully weighed all of their options and chosen the best alternative they can afford. Payday lending customers choose this financing option over an array of relatively unattractive options, such as pawn shops, bank overdraft protection, credit card cash advances (where available), and informal lenders or loan sharks. For instance, according to a study by the Federal Deposit Insurance Corporation, a customer repaying a $20 debit overdraft in two weeks would incur an average Annual Percentage Risk (APR) of 3,520 percent, which can be an unattractive alternative for a borrower . . . .

Misguided paternalistic regulation that deprives consumers of access to payday loans is likely to force many of them to turn to even more expensive lenders or to do without emergency funds.96

95 Edmiston, supra note 15, at 83.
Conclusion

It seems clear that, in our nation’s current economic environment, the need for affordable short-term credit is not abating. Indeed, as economic uncertainty and regulatory efforts evolve, the need for such credit is growing as an unprecedented number of Americans are living paycheck to paycheck. Reliable access to credit allows them to manage unexpected or unplanned expenses when they arise.

While some banks and credit unions have begun to offer short-term loans or account advances, most banking institutions do not offer short-term, small-dollar unsecured personal loans (e.g., $300-$500), and many financially challenged consumers cannot qualify for other, traditional forms of credit because of their credit records. The short-term bank and credit union programs that do exist are often inaccessible to such consumers as well, due to the various fees and conditions of these services. Despite attempts by regulators and other parties to encourage these institutions to offer such loans at no more than 36 percent APR, it does not appear that banks can be expected to do so to any significant degree because making the loan would not be profitable. And, various other efforts to develop innovative credit programs that can meet these consumers’ needs have shown little or no progress.

Existing credit options, therefore, ought to be preserved, not reduced. Financially challenged consumers should have a variety of credit options available to them, including payday loans. And they should be able to compare services, and evaluate them based on the associated costs and consequences. Roughly 20 million consumers obtained payday loans from regulated lenders last year. They benefited from having access to an affordable, cost-competitive and transparent service—one that is valued by the vast majority of customers. Payday loans provide many consumers with a simple, effective and affordable means of managing short-term financial difficulties, and allow them the chance to work through their problems.

If industry critics succeeded in eliminating payday loans, consumers would be forced to choose less regulated or more expensive credit options, or, in some instances, may not be able to obtain credit at all. They may fall behind on bills and other payments, leading to additional fees and penalties, or causing the loss of personal property. Clearly, consumers would not benefit from such a scenario.

Consumers should be smart about their money and savings, and any form of credit can be abused. But it is time for policymakers and other interested parties to acknowledge that for millions of financially challenged Americans payday loans are a sound choice and an effective financial tool for managing short-term financial needs.