



Fact Sheet

Payday Lending and Small Dollar Loans

The Problem

- As banks over time have stepped away from small-dollar loans in favor of credit cards and overdraft-type services, alternative providers arose to meet the demand.¹
- About 40 percent of payday loan recipients have bank accounts, suggesting that their payday loan provides a service that is not available from their bank.²
- Past unpaid debts or past problems with overdrafts will prevent some low-income persons from qualifying for banking accounts or for bank loans.²
- Families without bank accounts or access to affordable credit are less likely than other Americans to have a cushion for emergencies, to save for a home, or to build retirement security.³
- Lower-income persons may mistrust banks or misunderstand the comparative costs of informal financial services.²

Getting Caught In the Cycle

- Borrowers are usually drawn to payday lenders because they need cash before their next payday. Terms require full repayment almost immediately, which generally triggers repeat borrowing.⁴
- The average borrower is caught in the system for nine cycles, or about four to five months. Some customers pay on the interest for years before finding the resources to completely pay off the debt.⁴
- The annual interest rate charged by payday lenders is about 400 percent, or \$50 every two weeks for a \$300 loan, amounting to around \$450 in interest.⁴

¹ Herrmann, M. J., & Tescher, J. (2008). *A fundamental need: Small-dollar, short-term credit*. Chicago, IL: The Center for Financial Services Innovation.

² Blank, R. M. (2008). *Public policies to alter the use of alternative financial services among low-income households*. Washington, D.C.: Brookings Institution.

³ Stegman, M. (2001). The public policy challenges of payday lending. *Popular Government*, 66(3), pp. 16-22.

⁴ Center for Responsible Lending. (2008).

- About half of payday loan recipients claim to have considered a bank loan; many of these said that the payday loan involved an easier process; some also cited the convenient location of payday providers. Short-term loans to lower-income customers are simply not available through many local banks.²

Payday Lending in Texas

- Texas payday loans remain the most expensive in the U.S.⁵
- Payday lenders argue that charging 400 percent annual interest is the only way their business model can be profitable.⁶
- Texans take out an estimated \$2.5 billion in principal loan amounts per year and pay an additional \$500-\$600 million in annual interest and fees.⁵
- The average Texas family cannot afford the short-term interest on a \$300 payday loan while maintaining essential household necessities.⁵
- Of the approximately 2,000 payday-CSO storefronts across Texas, 92% are owned and operated by six firms.⁵
- There are more store fronts than McDonald's® and Whataburger® combined.⁵
- Payday lenders are able to evade Texas usury law and short-term interest rates established by the Texas Finance Code by claiming that they are loan brokers or arrangers.⁵

Solutions

- The most direct way to reduce the utilization of informal financial services is to expand and market competitive services through formal financial institutions. Products designed to provide access to short-term financing along with installment repayments would answer this market demand.²
- Employers (particularly larger employers) can require direct deposit, arranging for banks to provide debit accounts to unbanked employees, or can help employees open bank accounts.²
- Fifteen states have enacted legislation that have capped interest rates at two-digits, while others have limited rollovers or restricted the size of payday loans.⁴
- To address this growing problem, the Legislature should consider tightening statute to establish meaningful consumer safeguards and implement a reporting requirement for payday lenders.⁵

⁵ Baylor, D. (April 2008). The hidden costs of payday lending. *Texas Business Review*.

⁶ King, U., & Parrish, L. (2007). *Springing the debt trap: Rate caps are only proven payday lending reform*. Washington, D.C.: Center for Responsible Lending.