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Payday Loan Customers Want More Protections, Access to Lower-Cost Credit From Banks

Results of a nationally representative survey of U.S. borrowers

The Pew Charitable Trusts

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Overview

Payday loans typically carry annual percentage rates of 300 to 500 percent and are due on the borrower's next payday (roughly two weeks later) in lump-sum payments that consume about a third of the average customer's paycheck, making the loans difficult to repay without borrowing again. They are characterized by unaffordable payments, unreasonable loan terms, and unnecessarily high costs.

In June 2016, the Consumer Financial Protection Bureau (CFPB) proposed a rule to govern payday and auto title loans[1] that would establish a process for determining applicants' ability to repay a loan but would not limit loan size, payment amount, cost, or other terms. The CFPB solicited and is reviewing public comments on whether to include in its final rule alternatives to this process with stronger safeguards, particularly a 5 percent payment option that would limit installment payments to 5 percent of monthly income, enabling banks and credit unions to issue loans at prices six times lower than those of payday lenders, making lower-cost credit available at scale. An analysis by The Pew Charitable Trusts determined that the CFPB's proposal would accelerate a shift from lump-sum to installment lending but, without the 5 percent option, would shut banks and credit unions out of the market, missing an opportunity to save consumers billions of dollars a year.[2]

Previous Pew research found that payday loan borrowers want regulatory action to reform payday lending and expand lower-cost credit options, so in light of the CFPB proposal, Pew conducted a new nationally representative survey of 826 borrowers and found that:

- **70 percent of borrowers believe payday loans should be more regulated.**
- **Support for requiring installment payment structures is strong.** Three in 4 borrowers say having several months to repay and doing so in smaller installments would be major improvements, but most say additional underwriting would not.
- **Borrowers' priorities for reform include lower prices, affordable payments, and being able to obtain small loans from banks and credit unions.**
- **8 in 10 would prefer to borrow from a bank or credit union if they were equally likely to be approved, and 90 percent would do so if the loans cost six times less than those of payday lenders.** The pricing differential is based on payday lender fees for loans and on prices financial institutions would reportedly offer.

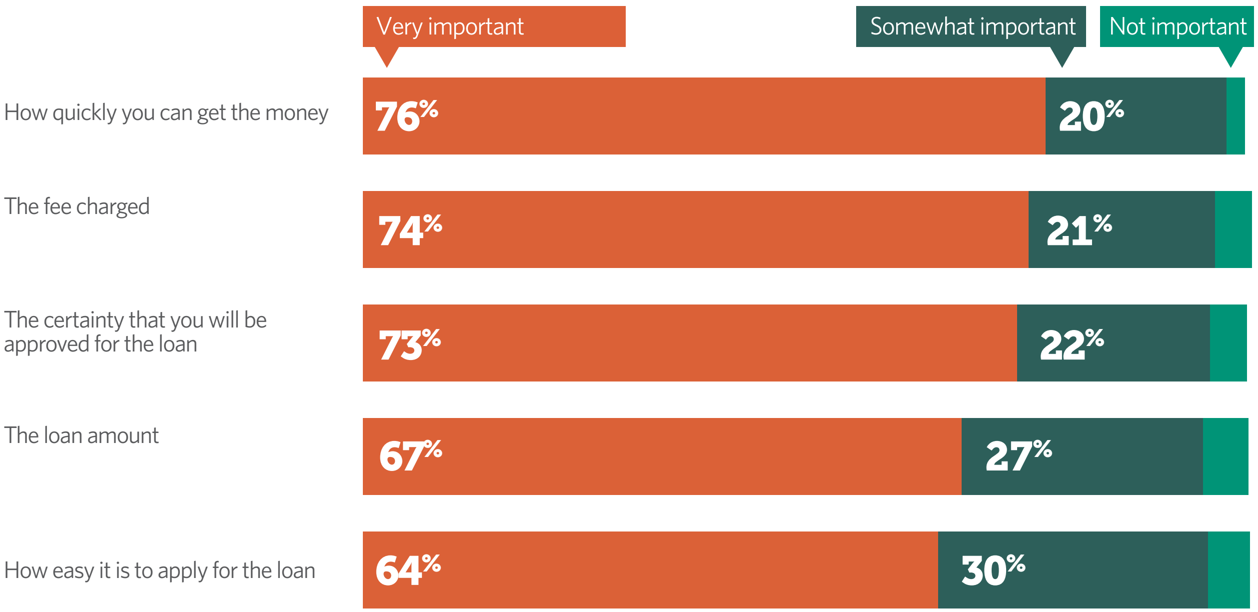
- **Virtually all would choose loans that cost six times less.** Ninety-two percent of borrowers say they would prefer the lower-cost credit that banks and credit unions would likely offer under the 5 percent payment option. Only 5 percent would opt for more expensive payday installment loans that went through the proposed ability-to-repay origination process.

These findings show that payday loan borrowers strongly favor reform and are especially supportive of steps that would encourage lower-cost bank and credit union loans. A separate survey of American adults found that the public shares these sentiments.[3] This chartbook discusses recommended changes to the proposal, including adoption of the 5 percent option, which is supported by Pew as well as many banks, community groups, and credit unions.

Figure 1

When Deciding Where to Get a Loan, Borrowers Say Speed, Cost, and Certainty Are Top Factors

Percentage of respondents by loan characteristic



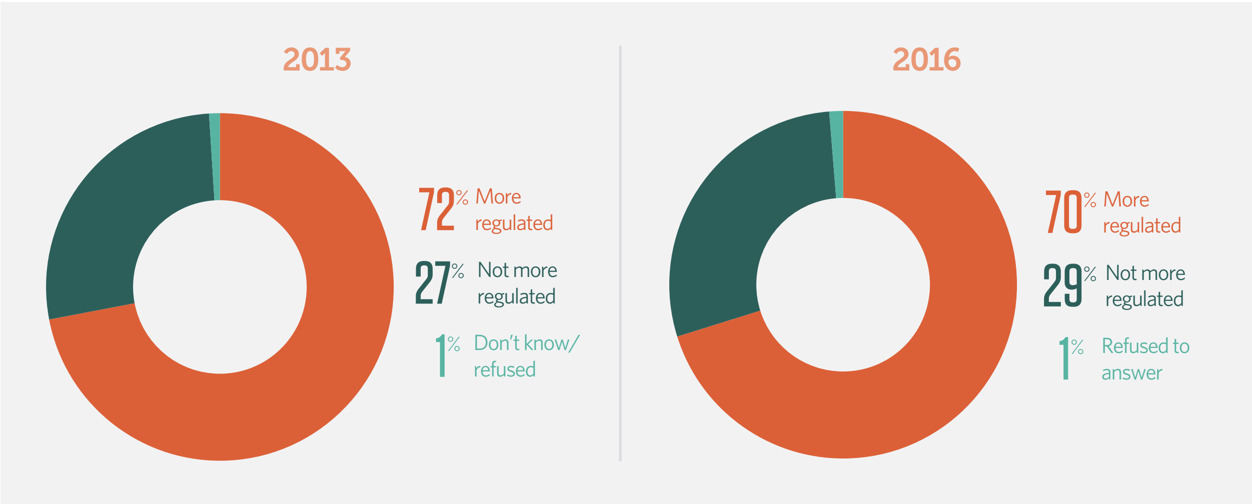
Notes: Respondents were asked: "In choosing where to get a payday loan, how important is the following to you? The fee charged; How quickly you can get the money; How easy it is to apply for the loan; The certainty that you will be approved for the loan; The loan amount." Then the respondents were asked: "You listed the following as "very important" when choosing to get a payday loan. Which one would you rank as the most important one?" Results are based on 826 interviews. Numbers do not total 100 percent because "refused" responses were omitted.

Those who cited multiple factors as "very important" were asked which was the most important. Thirty-nine percent chose "the fee charged"; 24 percent chose "how quickly you can get the money"; 21 percent chose "the certainty that you will be approved for the loan"; 11 percent chose "the loan amount"; and 6 percent chose "how easy it is to apply for the loan."

Figure 2

As They Did Three Years Ago, 7 in 10 Borrowers Still Want Payday Loans to Be More Regulated

Percentage of respondents, 2013 and 2016



Notes: Respondents were asked: "Should payday loans be more regulated or not?" Results are based on 826 interviews.

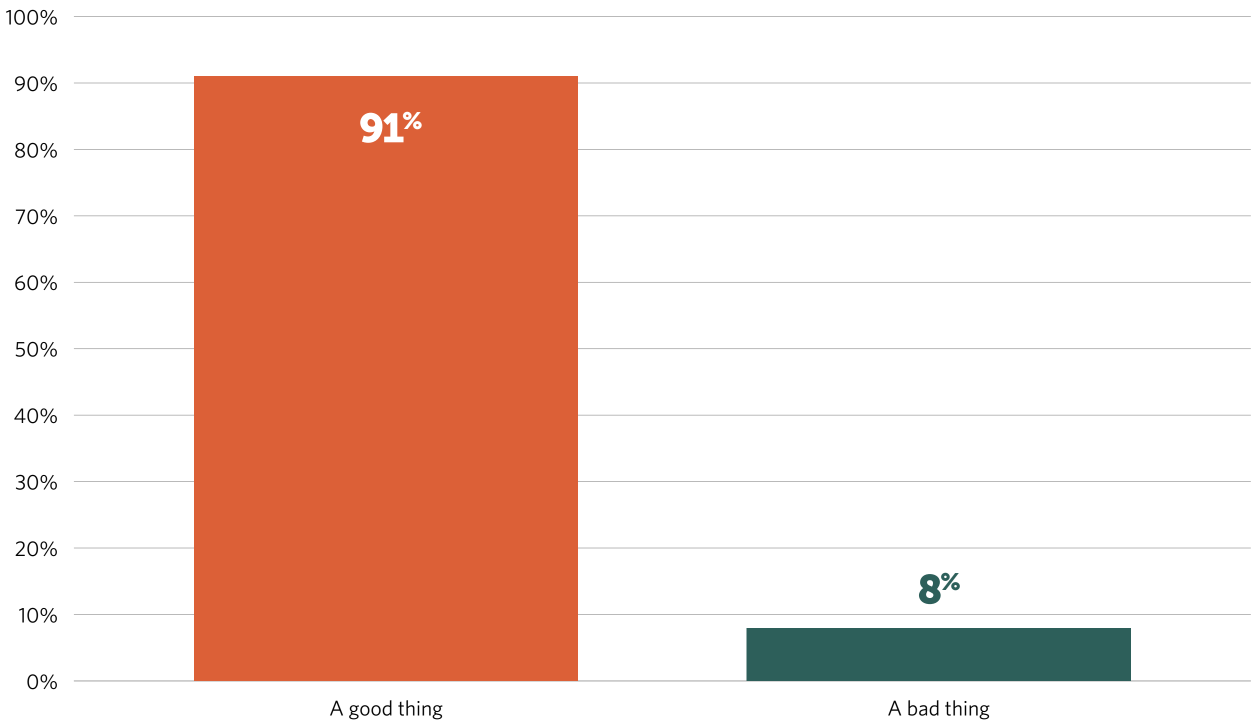
Source: The Pew Charitable Trusts, "Payday Lending in America: How Borrowers Choose and Repay Payday Loans" (2013), 48, http://www.pewtrusts.org/~/media/Assets/2013/02/20/Pew_Choosing_Borrowing_Payday_Feb2013-(1).pdf#page=48

Roughly 12 million Americans use payday loans annually, spending an average of $520 in fees to repeatedly borrow $375.[4]

Figure 3

9 in 10 Borrowers Say Having Fewer Payday Loan Stores and Lower Prices Would Be a Positive Change

Percentage of respondents



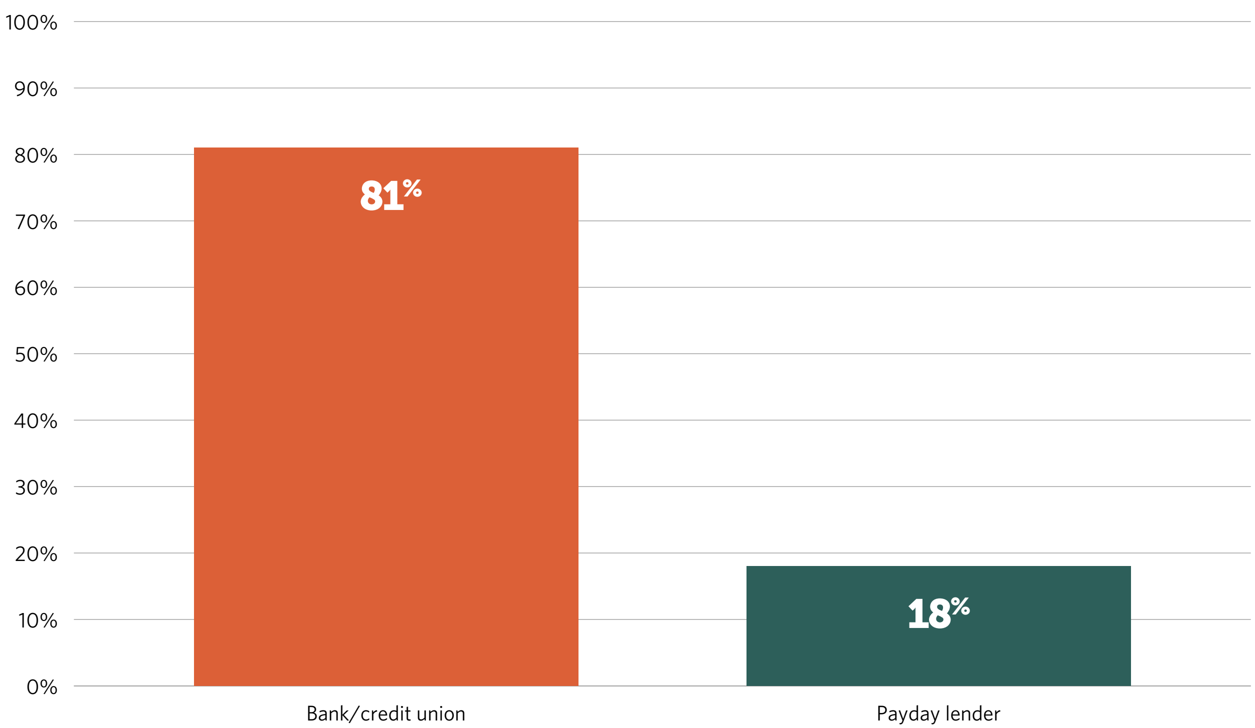
Notes: Respondents were asked: "If some of the payday loan stores closed in your area, but the remaining stores charged less for loans, would that be a good thing or a bad thing?" Results are based on 826 interviews. Numbers do not total 100 percent because "refused" responses were omitted.

In 2010, Colorado enacted a successful payday lending reform that led to the closure of more than half of payday loan stores over the ensuing five years but also doubled the number of customers served at each remaining store. The state required prices to be roughly three times lower than before the law changed, and lenders responded with improved efficiency. As a result, credit remains widely available, but loan payments now consume an average of 4 percent of a borrower's paycheck instead of the previous 38 percent. The reforms have saved Colorado borrowers more than $40 million annually.[5]

Figure 4

8 in 10 Payday Loan Customers Would Prefer to Borrow From a Bank or a Credit Union

Percentage of respondents by lender type



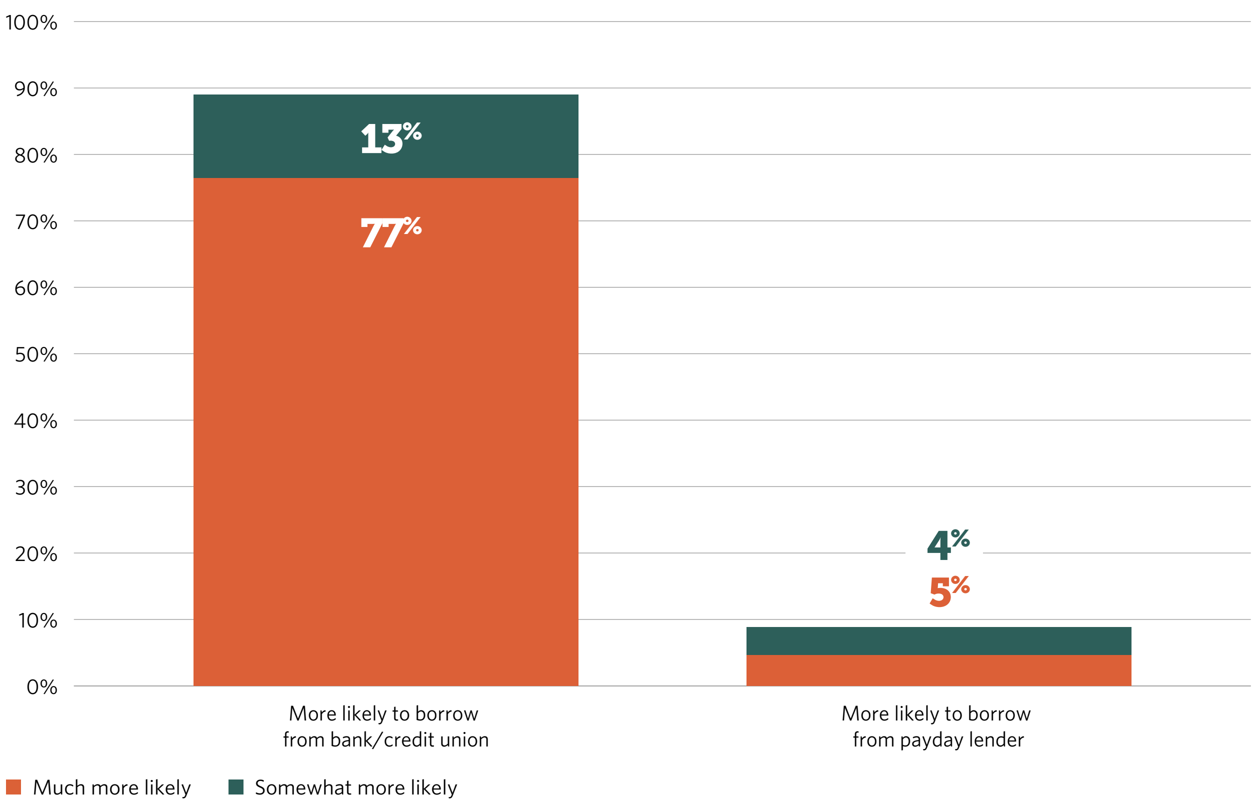
Notes: Respondents were asked the following: "If you were equally likely to be approved for a small loan, would you prefer to borrow from a payday lender, or from your bank/credit union?" Results are based on 826 interviews. Numbers do not total 100 percent because "refused" responses were omitted.

Every payday loan customer has a checking account at a bank or credit union because it is a loan requirement. Most customers would prefer borrowing from their bank or credit union instead of a payday lender as long as they were equally likely to be approved, but they cannot do so because regulatory uncertainty has made it difficult for banks and credit unions to issue small loans. Many financial institutions have expressed an interest in offering lower-cost, small-dollar credit to their customers who use payday loans, but only if they receive clear regulatory guidance that enables them to do so with simple underwriting.

Figure 5

9 in 10 Customers Would Borrow From Their Bank or Credit Union if Prices Were 6 Times Lower Than Payday Lenders'

Percentage of respondents by lender type



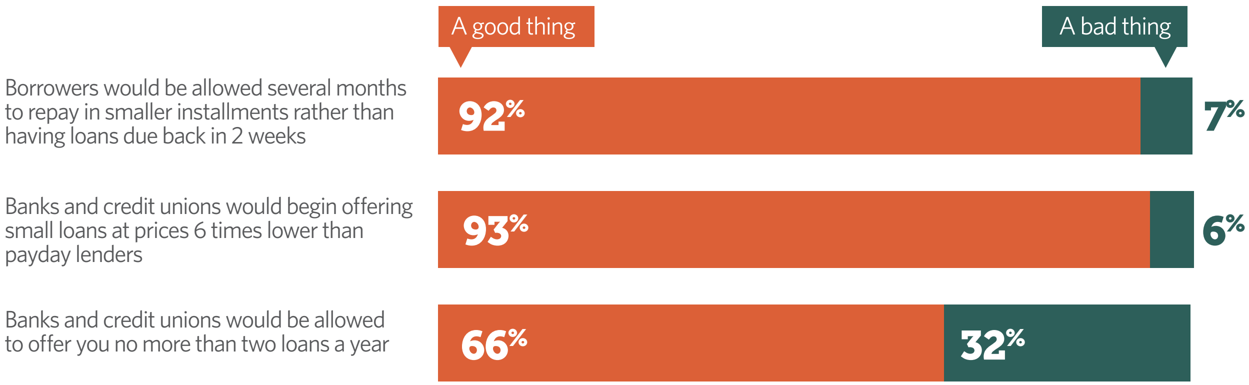
Notes: Pricing difference is based on published reports of banks' planned small-dollar loans. Respondents were asked: "Some banks and credit unions are considering offering a $400 three-month loan with a $60 fee. The same loan from a payday lender has a fee of about $350. If you were looking to borrow a small amount of money, would you be more likely to borrow from your bank/credit union or more likely to borrow from a payday lender?" Results are based on 826 interviews. Numbers do not total 100 percent because "refused" responses were omitted.

In May 2016, *American Banker* reported that at least three large banks were planning to offer small loans, repayable in affordable installments, at prices that were roughly six times lower than those of average payday loans.[6] Given the choice, most borrowers say they would use these lower-cost bank or credit union loans rather than payday loans. Financial institutions have stated that they would not be able to offer such loans under the CFPB's proposed ability-to-repay (ATR) test but would under the 5 percent payment alternative. Several bank and credit union trade associations have asked the bureau to include the 5 percent payment option in the final rule.[7]

Figure 6

Most Borrowers Say That Lower-Cost Bank Loans With More Time to Repay Would Be Good for Them

Percentage of borrowers by loan feature



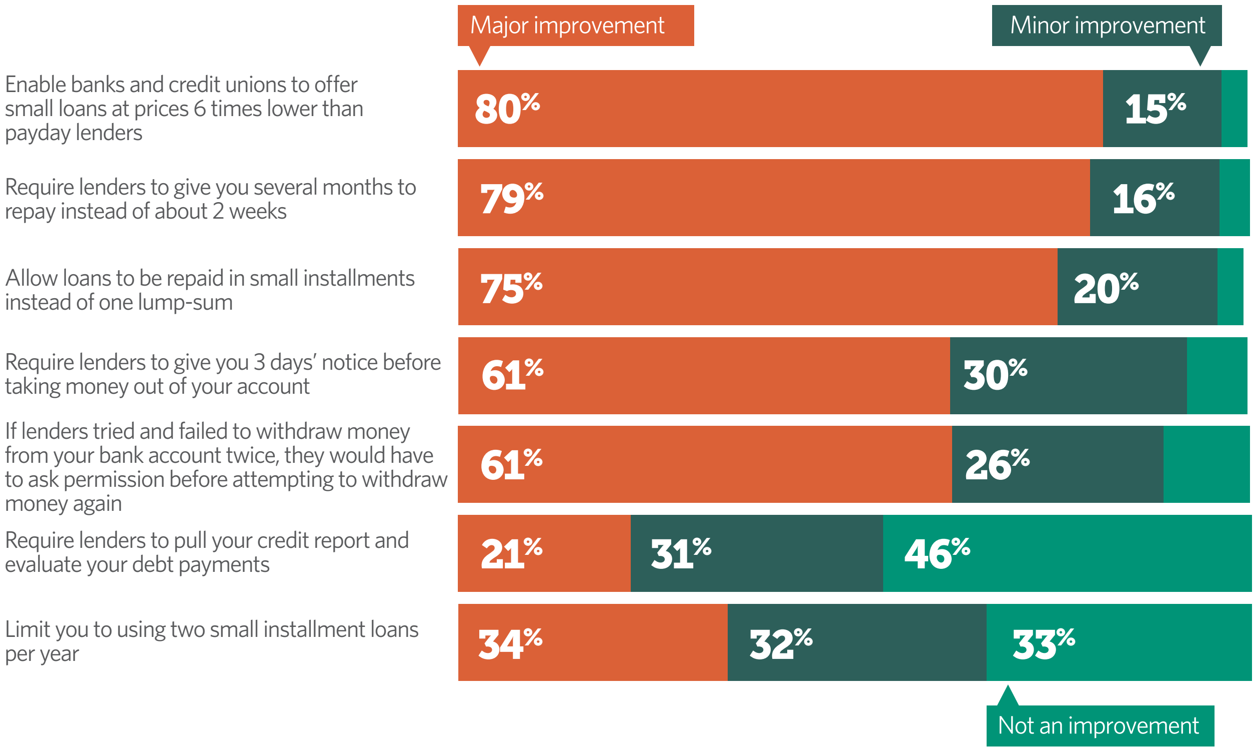
Notes: Respondents were asked: "New regulations are being considered for payday loans. The next few screens are some situations that might result because of the new regulations. Please select whether you think it would be a good thing or a bad thing for you: Borrowers would be allowed several months to repay in smaller installments rather than having loans due back in 2 weeks; Banks and credit unions would begin offering small loans at prices 6 times lower than payday lenders; Banks and credit unions would be allowed to offer you no more than two loans a year." Results are based on 826 interviews. The order in which these questions appeared was randomized in the survey. Numbers do not total 100 percent because "refused" responses were omitted.

If borrowers of high-cost credit were able to access loans from banks and credit unions that cost six times less than those offered by payday lenders, Pew estimates they would save more than $10 billion annually, more than the United States spends on some major anti-poverty programs such as Temporary Assistance for Needy Families basic assistance and Head Start.[8] Borrowers reacted positively to the idea of banks and credit unions offering lower-cost small loans.

Figure 7

Borrowers Say Lower Prices, More Time to Repay, and Smaller Payments Would Be Major Improvements

Percentage of respondents by potential regulation



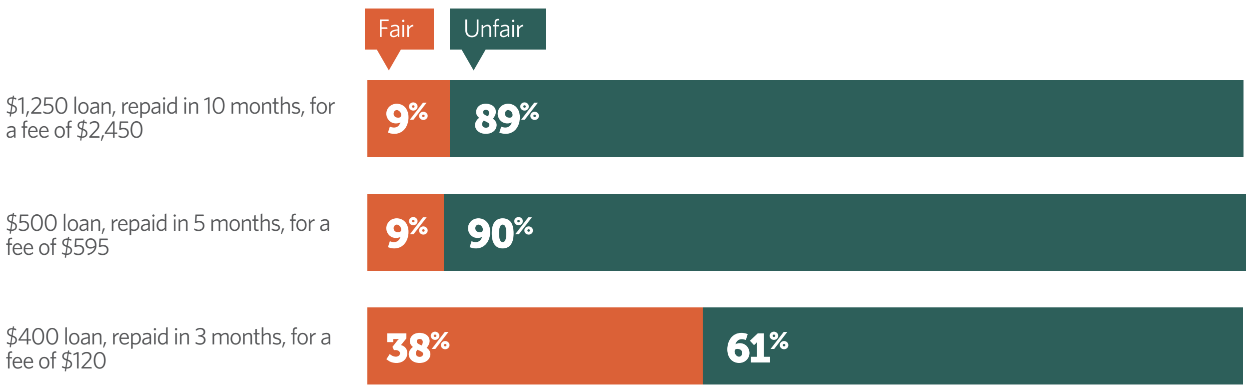
Notes: Respondents were asked: "The next few screens are some steps regulators could take to help improve payday and other small loans. For each, please respond by selecting how much of an improvement you think it would be: a major improvement, a minor improvement, or not an improvement. a) Enable banks and credit unions to offer small loans at prices 6 times lower than payday lenders; b) Require lenders to pull your credit report and evaluate your debt payments; c) Require lenders to give you several months to repay instead of about 2 weeks; d) Require lenders to give you 3 days' notice before taking money out of your account; e) Allow loans to be repaid in small installments instead of one lump-sum; f) If lenders tried and failed to withdraw money from your bank account twice, they would have to ask permission before attempting to withdraw money again; g) Limit you to using two small installment loans per year." Results are based on 826 interviews. The order in which these questions appeared was randomized in the survey. Numbers do not total 100 percent because "refused" responses were omitted.

When presented with possible components of the CFPB's final regulation, borrowers said loans with lower prices, more affordable payments, and reasonable installment structures would be a major improvement, but most said a debt evaluation process or a limit on the number of installment loans they could use was "not an improvement" or only a "minor improvement." The outcomes borrowers favored most were those that would probably result from the 5 percent payment option. The proposed rule relies heavily on a specific origination process that would make offering lower-cost installment loans at scale too difficult for banks and credit unions, but these institutions say they would be likely to offer such loans if the CFPB includes the 5 percent payment option in its final rule.

Figure 8

Borrowers Say Current Payday Installment Loan Charges Are Unfair

Share of respondents by loan type and terms



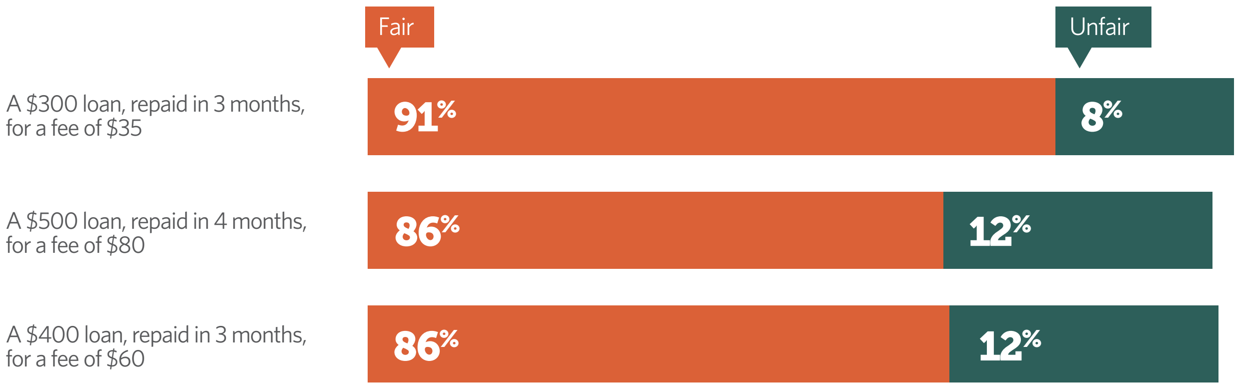
Notes: Respondents were asked: "Here is a loan that payday lenders might offer under the new regulations. Please select if you think the terms are fair or unfair. a) A $1,250 loan, repaid in 10 months, for a fee of $2,450 (meaning you borrow $1,250 and pay back a total of $3,700); b) A $500 loan, repaid in 5 months, for a fee of $595 (meaning you borrow $500 and pay back $1,095); c) A $400 loan, repaid in 3 months, for a fee of $120 (meaning you borrow $400 and pay back $520)." Results are based on 826 interviews. The order in which these questions appeared was randomized in the survey. Loan A has an APR of 206 percent, while Loan B has an APR of 401 percent, and Loan C has an APR of 172 percent. Data do not total 100 percent because "refused" responses were omitted.

Under the CFPB's proposed ATR provisions in which lenders would pull borrowers' credit reports, use a real-time database, and have an estimate of similar people's expenses, $1,250 and $500 loans, repayable in 10 and five months for $2,450 and $595 in fees, respectively, would probably continue to be offered. The bureau's commentary on the proposed rule stated that most payday installment loan borrowers would pass an ATR test for monthly payments of more than $300, which is larger than the monthly payments for many payday installment loans and more than borrowers say they can afford.[9]

Figure 9

Borrowers Say the Loans That Banks Would Be Likely to Offer Are Fair

Share of respondents by 5% payment option loans



Notes: Respondents were asked: "Here is a loan that banks might offer under the new regulations. Please select if you think the terms are fair or unfair. a) A $300 loan, repaid in 3 months, for a fee of $35; b) A $500 loan, repaid in 4 months, for a fee of $80; c) A $400 loan, repaid in 3 months, for a fee of $60." Results are based on 826 interviews. The order in which these questions appeared was randomized in the survey. Loan A has an annual percentage rate (APR) of 69 percent, while Loan B has an APR of 75 percent, and Loan C has an APR of 88 percent. Numbers do not total 100 percent because "refused" responses were omitted.

Figure 10

Payday Loan Customers Would Borrow From Their Banks if Loans Cost 6 Times Less

Percentage of borrowers by likely loan products

	Loan A	Loan B
Amount of loan	$500	$500
Cost of loan	$125	$750
Type of lender	Bank	Payday lender
Results	**93%**	**5%**

Notes: Respondents were asked: "The next few screens will show some small loans that last a few months and might be available to people who are looking to borrow money to pay an urgent bill. If you were looking to borrow a small amount of money, please mark whether you would choose Loan A or Loan B." Results are based on 826 interviews. Numbers do not total 100 percent because "refused" responses were omitted.

Banks and credit unions could offer five-month loans of $500 for a $125 fee under a 5 percent payment option, which borrowers say compare favorably to the $500 loans with $750 fees that payday lenders would be likely to issue under the proposed ATR provision. Unless the proposed regulations are modified, high-cost loans are the only ones likely to be widely available.

Figure 11

Nearly All Borrowers Prefer Loans With Lower Prices and Simple Origination Processes

Percentage of borrowers by likely loan products

	Loan A	Loan B
Amount of loan	$500	$500
Cost of loan	$75	$450
How the lender assesses whether you qualify	Based on your checking account history, income, and history with the bank	Based on your credit report, income, and the lender's estimate of your expenses
Results	**92%**	**5%**

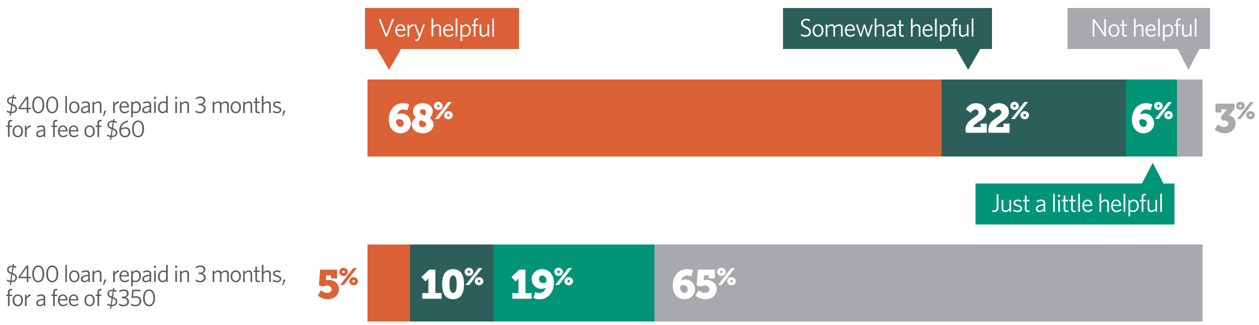
Notes: Respondents were asked: "The next few screens will show some small loans that last a few months and might be available to people who are looking to borrow money to pay an urgent bill. If you were looking to borrow a small amount of money, please mark whether you would choose Loan A or Loan B." Results are based on 826 interviews. Numbers do not total 100 percent because "refused" responses were omitted.

If banks are allowed to issue loans under the 5 percent payment option using the borrower's checking account history and income information for underwriting purposes, they will be likely to offer a three-month loan of $500 for $75 in fees. Most borrowers would choose this loan over a $500 loan with $450 in fees that payday lenders would be likely to issue under the proposed ATR provision.

Figure 12

Borrowers Say Cost Is Crucial to the Helpfulness of Small Loans

Percentage of respondents who say each loan is a benefit



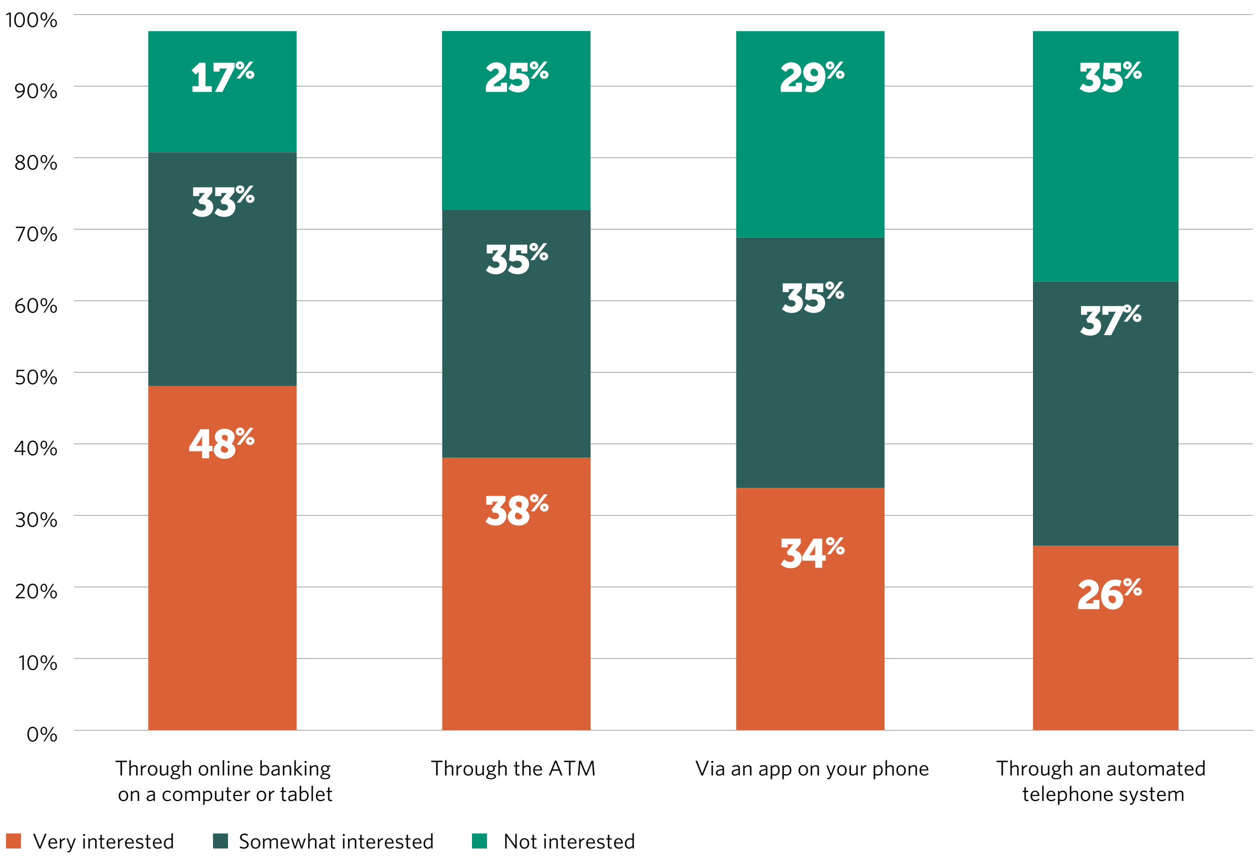
Notes: Respondents were asked: "If you were short on cash, how helpful do you think the following loan would be? a) A $400 loan, repaid in 3 months, for a fee of $60 (meaning you borrow $400 and pay back $460); b) A $400 loan, repaid in 3 months, for a fee of $350 (meaning you borrow $400 and pay back $750)." Results are based on 826 interviews. The order in which these questions appeared was randomized in the survey. Numbers do not total 100 percent because "refused" responses were omitted.

Advocates of payday loans frequently point to the help that readily available, small-dollar credit provides to borrowers when financial difficulties arise. And although borrowers agree that credit can be beneficial, they say cost is a major factor in determining whether loans are helpful. Banks would be likely to offer loans of $400 for a fee of about $60 if the 5 percent payment option is included in the CFPB's final rule, while payday lenders would charge fees of around $350 for the same $400 loan issued under the proposed longer-term ATR provision, meaning borrowers view the potential bank loans as far more helpful than payday installment loans. The bank loan with a $60 fee would have an APR of 88 percent, compared with an APR of 473 percent for the payday loan.

Figure 13

Borrowers Are Interested in Obtaining Bank Loans Electronically

Percentage of respondents by lending channel



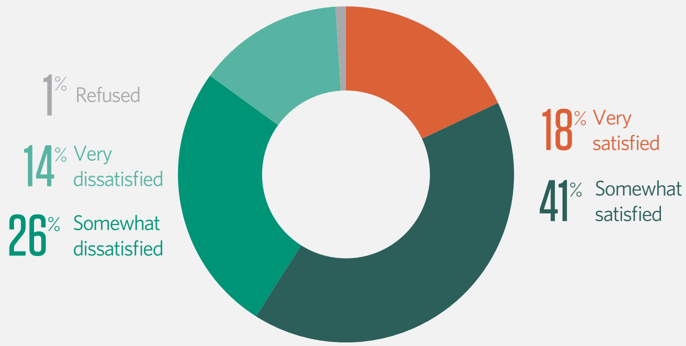
Notes: Respondents were asked: "The next few screens are some ways that your bank could offer small loans. Please mark whether you would be very interested in obtaining a loan this way, somewhat interested, or not interested. a) Via an app on your phone; b) Through online banking on a computer or tablet; c) Through an automated telephone system; d) Through the ATM." Results are based on 826 interviews. The order in which these questions appeared was randomized in the survey. Numbers do not total 100 percent because "refused" responses were omitted.

Consumers are interested in obtaining loans through online banking and other channels. To keep costs down, banks would need to be able to issue loans using electronic and other automated methods that do not require staff time to process applications or disburse funds, but banks need clear standards to support such automation for lower-cost small-dollar loans. The ability to prescreen customers for eligibility, automate the origination process, and deposit proceeds immediately into checking accounts are the factors that would enable banks to profitably offer small loans at prices much lower than those of payday lenders.

Figure 14

Borrowers Report Mixed Feelings About Current Loan Options at Their Bank

Percentage of respondents by satisfaction level



Notes: Respondents were asked: "How satisfied are you with your bank's loan options that are available to you today?"/"When you had a bank account, how satisfied were you with the bank's loan options that were available to you?" Results are based on 826 interviews. Numbers do not total 100 percent due to rounding.

Figure 15

Borrowers Responded Positively When Asked About Banks Offering Small-Dollar Loans

Selected answers to "What would it say to you about your bank if they started offering small loans?"

That the bank cares:

- It would say that my bank cares about me more than a payday lender.
- I would think that they are interested in helping people who are going through hard times.
- That they cared about average people.
- They care about their customers and are reasonable.

That the bank is fair and helpful:

- It says that my bank is interested in being fair.
- They are willing to help people who are experiencing difficulties.
- That the bank is trying to be helpful to middle- or lower-class families.
- That banks were finally trying to help people in need.

That borrowers can stop using payday loans:

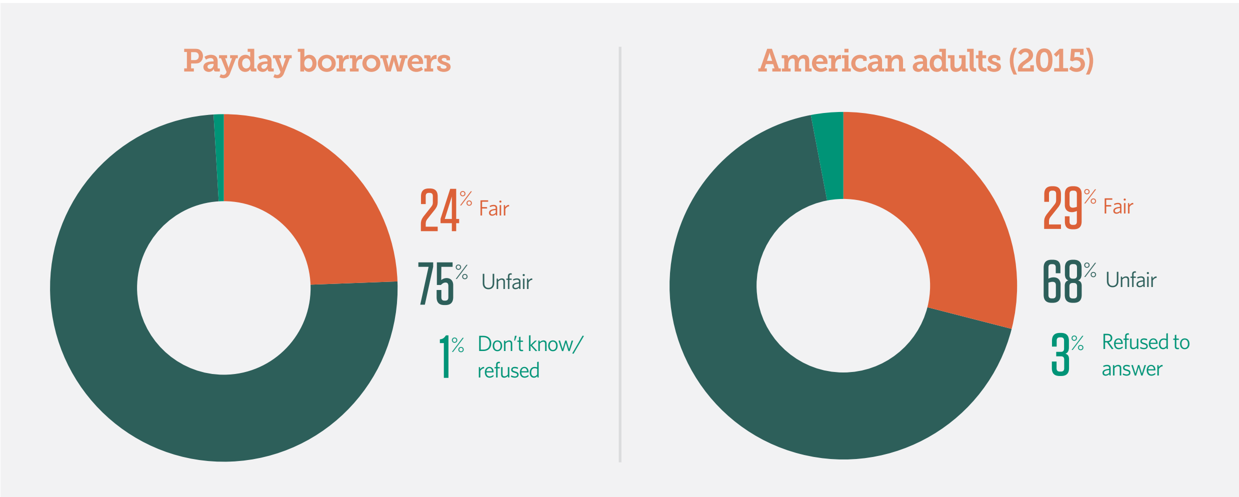
- That would be awesome. I would stop going to payday lenders.
- I would use that option before using an overpriced payday loan.
- It might help me finally get rid of my payday loan.
- That they are helping you get a small loan with a small fee, so the payday loans don't rip you off.

Note: Respondents were asked an open-ended question: "What would it say to you about your bank if they started offering small loans you could qualify for, repaid in a few months at a price six times lower than payday lenders?" Quotes were selected from among 826 interviews.

Figure 16

3 in 4 Borrowers and Most Americans See a $35 Checking Account Overdraft Fee as Unfair

Percentage of borrowers and U.S. population



Notes: Respondents were asked: "Today, banks typically charge a fee of around $35 for each overdraft. Do you think that's fair or unfair?" Results are based on 826 interviews.

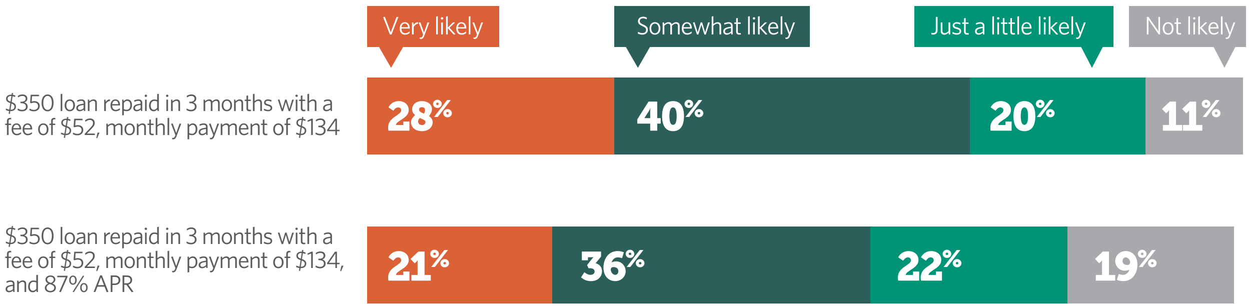
Source: The Pew Charitable Trusts, "CFPB Proposal for Payday and Other Small Loans: A Survey of Americans" (2015), 7, http://www.pewtrusts.org/~/media/assets/2015/07/cfpb_chartbook.pdf#page=9

As shown in Figure 9 on Page 11, 9 in 10 borrowers see a $35 fee for a $300, three-month loan as fair, but 3 in 4 believe it is unfair to charge the same amount for a checking account overdraft. Current regulation does not support borrower preferences because it permits such overdraft fees but does not enable banks to offer lower-cost small-dollar loans at scale.

Figure 17

Most Payday Loan Borrowers Would Use Lower-Cost Bank Loans if Short on Cash

Percentage of respondents by loan product



Notes: Half of respondents were asked: “If you found yourself short on cash, how likely would you be to take this loan? $350 loan repaid in 3 months with a fee of $52, monthly payment of $134.” The other half were asked: “If you found yourself short on cash, how likely would you be to take this loan? $350 loan repaid in 3 months with a fee of $52, monthly payment of $134, and 87% APR.” Results are based on 826 interviews. Numbers do not total 100 percent because “refused” responses were omitted.

Emphasizing annual percentage rate information does little to dissuade borrowing, deterring only about 1 in 10 respondents: When APRs are featured prominently, 57 percent of payday loan borrowers say they would be likely to use such a loan if short on cash, compared with 68 percent when APR is not highlighted.

Methodology

On behalf of The Pew Charitable Trusts, the GfK Group conducted a national study of 826 payday loan borrowers Aug. 23-28, 2016. The survey was conducted using KnowledgePanel, a probability-based web panel designed to be representative of the United States. The survey consisted of two stages: initial screening for borrowers and the main survey with the study-eligible respondents. To qualify for the main survey, a panel member must have used a payday loan (at a store or online).

The margin of error including the design effect is plus or minus 4 percent at the 95 percent confidence level. A detailed methodology is available at http://www.gfk.com.

Endnotes

1 Consumer Financial Protection Bureau, "A Proposed Rule for Payday, Vehicle Title, and Certain High-Cost Installment Loans," June 2, 2016, https://www.federalregister.gov/documents/2016/07/22/2016-13490/payday-vehicle-title-and-certain-high-cost-installment-loans. For a summary of the proposed rule, see http://www.pewtrusts.org/en/research-and-analysis/analysis/2016/09/07/how-the-cfpb-proposal-would-regulate-payday-and-other-small-loans.

2 The Pew Charitable Trusts, "How CFPB Rules Can Encourage Banks and Credit Unions to Offer Lower-Cost Small Loans," (2016), http://www.pewtrusts.org/en/research-and-analysis/analysis/2016/04/05/how-cfpb-rules-can-encourage-banks-and-credit-unions-to-offer-lower-cost-small-loans.

3 The Pew Charitable Trusts, "Americans Want Payday Loan Reform, Support Lower-Cost Bank Loans" (2017), www.pewtrusts.org/en/research-and-analysis/issue-briefs/2017/04/americans-want-payday-loan-reform-support-lower-cost-bank-loans.

4 The Pew Charitable Trusts, "Who Borrows, Where They Borrow, and Why" (2012), 9, http://www.pewtrusts.org/~/media/legacy/%20uploadedfiles/pcs_assets/2012/pewpaydaylendingreportpdf.pdf.

5 The Pew Charitable Trusts, "Trial, Error, and Success in Colorado's Payday Lending Reforms" (2014), 6, http://www.pewtrusts.org/~/media/assets/2014/12/pew_co_payday_law_comparison_dec2014.pdf.

6 Ian McKendry, "Banks' Secret Plan to Disrupt the Payday Loan Industry," *American Banker*, May 6, 2016, http://consumerbankers.com/cba-media-center/cba-news/banks-secret-plan-disrupt-payday-loan-industry.

7 The Pew Charitable Trusts et al., group comment letter on the CFPB's Notice of Proposed Rulemaking for Payday, Vehicle Title, and Certain High-Cost Installment Loans, Oct. 6, 2016, https://www.regulations.gov/document?D=CFPB-2016-0025-142119. The signatories on this letter include nonprofit leaders, credit counselors, researchers, and representatives of banks that collectively operate 1 in 6 bank branches in the United States.

8 Center on Budget and Policy Priorities, "How States Use Federal and State Funds Under the TANF Block Grant" (2015), http://www.cbpp.org/research/family-income-support/how-states-use-federal-and-state-funds-under-the-tanf-block-grant; U.S. Department of Health and Human Services, "Head Start Program Facts: Fiscal Year 2015," last modified Feb. 8, 2017, https://eclkc.ohs.acf.hhs.gov/hslc/data/factsheets/2015-hs-program-factsheet.html.

9 The Pew Charitable Trusts, "Payday Lending in America: How Borrowers Choose and Repay Payday Loans" (2013), 13, http://www.pewtrusts.org/~/media/assets/2013/02/20/pew_choosing_borrowing_payday_feb2013-(1).pdf; The Pew Charitable Trusts, "From Payday to Small Installment Loans" (2016), 7, http://www.pewtrusts.org/~/media/assets/2016/08/from_payday_to_small_installment_loans.pdf; Consumer Financial Protection Bureau Proposed Rule, 12 CFR 1041 (2016), 48137–38.

For further information, please visit:

pewtrusts.org/small-loans

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