The Short Term Loans Market — State of the Industry 2018

During the past few years, lenders offering short term loans have faced mounting criticism related to their products as well as their business models. New and pending regulations covering payday, cash advance, installment and other small-dollar personal loans have affected the industry in various ways. Whether lenders make these loans through a physical store or a website, they are being forced to adapt to change in order to survive. This report explores the state of the industry as of 2018.

What is the Current State of the Short Term Loan Industry?

Briefly stated, the overall picture of the short-term, small-dollar lending industry is an image of a legitimate industry that is under attack from many sides. Negative statements about the industry have been made by consumer groups, comedians, federal agencies, state legislators and politicians; even President Obama went on record as opposing payday loans. The media attention and new regulations have thrown the industry into a state of flux as lenders, facing an uncertain future, look for ways to survive. From overhauling their loan products to moving from storefront to internet loans, lenders are proactively searching for ways to serve their customers while complying with a series of regulations that are becoming increasingly complex.

What Is a Short Term Loan?

Short term loans online application forms make applying for credit a simple process, even with bad credit.

By definition, short term loans are those that are to be repaid quickly. The repayment term is typically no longer than 12 months, but some loans may have longer repayment schedules. These loans are not a line of credit or a form of revolving credit. Instead, they are one-time loans, so if the borrower needs additional funds in the future, he or she must submit another loan application.

Although "salary lenders" were active over 100 years ago, they disappeared during the first half of the 20th century. State regulations contributed to their demise, but the primary reason was the growth of the consumer financial industry. By the 1950s, personal loans enjoyed widespread access among borrowers, as well as credit cards, mortgages and other credit products, reducing the need for salary loans.

What Is a Payday Loan?

The advance payday loans marketplace has lost market share to payday installment loans in the last two years.

Payday loans are small-dollar, short term loans that are typically due in full on the borrower's next payday. However, the due date does not have to coincide with the payday. Some lenders may allow two weeks for repayment even if the borrower is paid weekly. In some states, the minimum and maximum repayment terms are defined by law.

Many modern payday lenders began as check-cashing services. People without bank accounts as well as those with checking accounts who needed to get cash outside of banking hours could cash their checks at the service. Most services also sold money orders, accepted payments for utility bills and offered wire transfers. It was a natural evolution for these services to start making loans that were secured by a post-dated check issued by the borrower.

Although borrowers are not all the same, payday lenders have become known for making short term loans to customers with credit difficulties. The typical borrower has a low credit score that is below the acceptable threshold at most credit unions and traditional financial institutions. Many lenders do not base their decisions on the borrower's credit report, but most lenders require that borrowers have checking accounts and verifiable sources of income.

What Is a Cash Advance?

Cash advances play an important role in modern personal finance and consumer lending markets

Within the industry, a cash advance is essentially the same as a payday loan. The loan amounts are similar, typically less than $500 although some lenders offer larger loans. The loans are usually repaid in a lump sum; repayment may be scheduled 14 to 30 days after the loan is finalized. These loans are sometimes called paycheck advances.

Whether the lender chooses to call the product a cash advance or a payday loan depends on the lender's preference and may reflect the company's history. Many lenders making these types of loans from physical stores chose to emphasize that borrowers received their loans in cash rather than a check. Today, however, borrowers can apply for an online cash-advance loan and have the funds electronically deposited in their bank accounts although they may still receive cash when they take out either type of loan at the lender's store.

It is important to note that these loans are not the same as cash advances on a credit card. Many credit cards offer the option for cardholders to obtain cash at a bank or ATM. Naturally, the open credit on the card must be sufficient to cover the advance, and most issuers allow only a certain percentage of the total credit line to be taken in cash.

Installment credit is easily obtained, and loans are available online or in person.

What Is an Installment Loan?

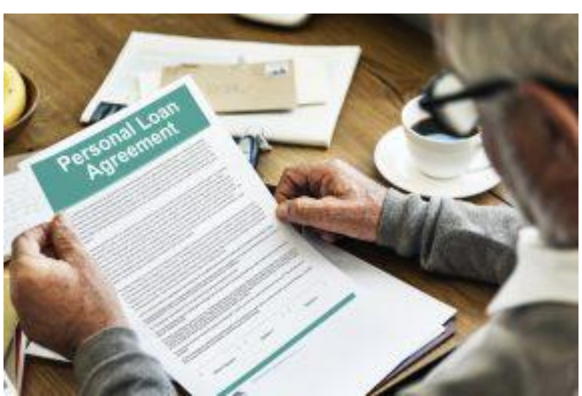
Installment loans are loans that are repaid through a series of payments. Payments are typically due monthly, and each payment is for the same amount or varies by only a penny or two.

Installment loans are close-ended loans. That is, they are made for a specific amount, and in some cases, they are made for a specific purchase. For example, mortgages are long-term installment loans typically used to purchase a home and secured by the home. Car loans are another example of a secured loan repaid in installments. Store-financed furniture and appliance loans are also typically repaid through scheduled monthly payments.

Payday installment loans work in a similar fashion, but they are considered short term installment loans. Because the monthly payments may make budgeting easier, some borrowers are choosing loans that allow repayment in installments over loans requiring a lump-sum repayment. The exact loan term depends on the lender, the amount borrowed and any applicable state laws.

Many payday lenders offer installment loans for people with bad credit as well as installment cash loans online. The loan amounts, qualifications and interest rates vary by lender, but as a rule, the loan amounts are more generous than for short-term loans requiring repayment in a lump sum.

What Is a Personal Loan?



Unsecured personal loans enable financial flexibility for borrowers.

Basically, all loans obtained for non-business reasons could be considered personal loans. However, within the short-term loan industry, the term commonly refers to an unsecured loan. Secured loans are backed by collateral that the lender can seize should the borrower default on the loan; mortgages, car loans, title loans and pawned merchandise are all examples of secured loans. Borrowers obtaining unsecured personal loans do not pledge collateral, so lenders have only the borrower's word that he or she will repay the loan. These loans are sometimes called signature loans.

Since lenders take greater risks when making unsecured personal loans, they may have different requirements than they do for payday loans. They may run a credit check to determine the borrower's credit score and payment history, but most lenders base their decision on more than just the borrower's official credit report. Many lenders offer no-credit personal loans as well as personal loans for people with bad credit.

Although personal unsecured loans share some similarities with cash advance and payday loans, there are a few notable differences.

• A personal unsecured loan spreads the payments over a longer time. The payment plan can range from several months to as long as two years, depending on the lender, state laws and the loan amount. Cash advance and pay day loans typically require that the entire loan and all fees be repaid in full in less than 30 days.
• Few lenders request credit checks for loans to be repaid on the next payday; it is simply too expensive and time-consuming given the relatively small loan amounts and the brief loan term.
• Depending on the lender, personal loans and/or the payments made on them may be reported to one or more of the major credit bureaus; timely payments may help the borrower's credit, but defaulting on the loan could hurt it.
• Many lenders set their maximum loan amounts much higher for personal installment credit products than for other types of short-duration loans. Some borrowers find that the higher loans offer better solutions to long-term financial issues.

How Large Is the Industry?

As of 2015, payday lenders operated approximately 20,600 stores in the United States, according to the Community Financial Services Association of America. The industry extended short-term credit to an estimated 19 million households for a total of approximately $38.5 billion. Furthermore, the industry paid $2 billion in wages to over 50,000 employees, generating over $2.6 billion in state, local and federal taxes.

Since 2015, the industry has experienced a decline in the number of physical stores and overall shrinkage that has not been offset by a modest increase in online lenders. According to an article published in April 2017 by The Economist, lenders closed over 500 stores between January and September of 2016. Employment declined by 3.5 percent, the equivalent of 3,600 people. Paycheck advance loans have dropped 18 percent since 2014, while revenues fell by 30 percent.

The Consumer Financial Protection Bureau, created following the economic collapse of 2008, estimates that loan volumes could be reduced by over 80 percent if proposed regulations are enacted. If the regulations cause a similar shrinkage in the number of people employed by the industry, up to 40,000 employees could find themselves without jobs. Applying the same metric reveals the potential loss of approximately $2 billion in tax revenue.

Loan Usage Breakdown by Demographics

Although several academic researchers, consumer groups and news agencies have surveyed people who use small-dollar, short term loans, no unified picture of the average borrower has emerged. Demographics depend on the sample size, when the survey was conducted and where the borrowers were located.

The Pew Charitable Trusts, an outspoken critic of the industry, conducted a study using data from 2010. According to its report, 58 percent of the borrowers were white, 52 percent were female, 58 percent were renters, 72 percent had household incomes below $40,000 and 52 percent were between the ages of 25 and 44. Approximately 85 percent had less than a bachelor's degree.

After applying a logistic regression model to control for other factors, Pew calculated the odds of certain groups borrowing from a payday lender. They found that renters were 57 percent more likely than homeowners to borrow from a payday lender. The odds were 103 percent higher for people who were divorced or separated than for people who were single, married, widowed or living with a partner. African Americans had a rate that was 105 percent higher than other ethnicities and races. Those with annual earnings below $40,000 were 62 percent more likely to use low-dollar short term loans.

However, when asked whether they had used a payday loan within the last five years, the study revealed that payday borrowers spanned all ages, income levels, marital status, education level, ethnicities and living arrangements.

• African Americans accounted for less than 25 percent of all payday borrowers, but they were three times as likely to have used the services of a payday lender than whites and twice as likely to be a payday borrower than Hispanics.
• Parental status affected usage of short term loans, especially when income was factored into the equation. Approximately 12 percent of parents with earnings below $50,000 had borrowed from a payday lender, but only 4 percent of those earning at least $50,000 had done so.
• Although 13 percent of divorced or separated individuals reported borrowing from a payday lender, 10 percent of those living with a partner reported that they had used payday loans. For the other categories of marital status, the results were 7 percent of the single respondents, 5 percent of the married ones and 4 percent for those who had been widowed.
• Approximately 2 percent of those who had borrowed from a payday lender had postgraduate degrees, 3 percent had undergraduate degrees and 7 percent reported having some college.

Pew's study also revealed that geography affected usage. For example, in the states of Texas, Oklahoma, Louisiana and Arkansas, the usage rate was 8 percent. New England has the lowest usage rate — 2 percent — while California, Oregon and Washington reported 6 percent.

Furthermore, borrowing was less common in small towns and the suburbs than in cities and rural areas.

In 2016, MDRC, formerly the Manpower Demonstration Research Corporation, released its own report on payday lending after analyzing almost 200,000 borrower records and over 880,000 records related to geographic factors. MDRC found that 20 percent of the borrowers had gross incomes of more than $52,000 annually and net incomes in excess of $40,000 per year; the average net income for all borrowers was approximately $30,000 annually. Approximately 34 percent owned their homes. Almost 30 percent had a bachelor's degree, 14 percent had an associate's degree and 13 percent had a postgraduate degree.

MDRC asked questions that are often not covered by surveys of borrowers using payday lenders. The report found that over 35 percent of the respondents had a home equity loan or mortgage, almost 60 percent had student loan debts, more than 47 percent had total debts in excess of $20,000 and 50 percent were currently making payments on medical bills even though more than 90 percent said that they had medical insurance. When asked about their total nonretirement savings, almost 54 percent reported having none, over 25 percent had less than $500 and 15.6 percent stated that they had at least $1,000. Nearly 79 percent reported that they had been denied credit due to no credit or poor credit in the last year, but almost 74 percent stated that they had once had a credit score of at least 650.

The MDRC study found that approximately 8 percent of the borrowers taking out short term loans were at least 60 years old, 2 percent were under 25, meaning that approximately 90 percent were aged 25 to 59. Almost 13 percent of the respondents identified as Hispanic, 27.9 percent were African American and more than 52 percent were white. Slightly more than half were married, and roughly the same percentage had children under the age of 18 living with them.

Industry Controversy and Criticism

The short term, small-dollar loan industry has been mired in controversy for years. On one side are those who feel that the industry provides a valuable service to millions of consumers who do not have access to traditional credit products. The opposition likens payday lending to legalized loan sharking and claim that the lenders do more harm than good.

The Consumer Financial Protection Bureau has been one of the most powerful critics of the industry. The creation of the CFPB was authorized by the Dodd-Frank Act, a piece of legislations that was enacted in response to the economic meltdown of 2008. Most of the bill concerns strengthening regulations for mortgages, banks and investment firms. However, the stated aim of promoting financial stability included a far-reaching clause of protecting consumers from abusive practices committed by financial service providers as well as unspecified "other purposes." The CFPB was officially established in July 2010, but most of the agency's activities began in July 2011.

The timeline is significant as the CFPB states that it began researching payday and similar short term loans in 2012. In other words, the CFPB began focusing on the industry almost as soon as it was officially granted investigative powers. Some people have felt that since the financial crisis was not tied to the small-dollar loan industry, the attention focused on the industry by the CFPB was unusual.

When the CFPB announced its proposal for new industry regulations in June 2016, the agency justified the proposed rules by citing the results of its research.

• Within 30 days, almost 70 percent of the borrowers took out another loan, and approximately 20 percent of the borrowers took out 10 or more consecutive loans.
• Over 33 percent of borrowers taking out payday installment loans defaulted on the loans.
• About half of the borrowers using online lenders paid bank penalty fees averaging $185. According to the CFPB, the fees were the result of repeated attempts by the lenders to collect electronic payments from borrowers' checking accounts.

In addition, the CFPB used the data to draw certain conclusions that painted the industry in a negative light.

• The CFPB stated that payday and deposit advance loans could trap consumers in a cycle of debt. Their research showed that many borrowers renewed their loans repeatedly or took out additional loans soon after repaying a previous loan.
• Lending policies were often loose; lenders frequently did not consider whether borrowers had the ability to repay or take into account the borrower's other financial obligations. Credit scores were generally not considered.
• The requirement to pay back a lump sum could prove difficult for borrowers who were already strapped for cash, leading them to secure another loan to meet living expenses and other financial obligations.
• The CFPB felt that the loan duration was too short. The median loan term was 14 days, giving borrowers little time to gather the funds to repay the loan and still cover other expenses.
• The fees charged for loans meant for such short durations were too high, according to the CFPB. The agency found that fees ranged between $10 and $20 for every $100 borrowed. The CFPB computed that a loan charging a $15 fee and outstanding for 14 days would be the equivalent of a 391-percent annual percentage rate.

The CFPB has not been alone in its criticism of the industry. The Pew Charitable Trusts stated that for most borrowers, the total fees paid exceeded the amount borrowed. The calculation was based on an average fee of $55 on a loan of $375 with a due date in two weeks. Pew stated that the average borrower was in debt for five months, bringing the total fees to $520.

Pew's research indicated that most borrowers could not afford to commit more than 5 percent of their gross paycheck to repaying a loan if they were to cover basic expenses. However, according to Pew, the average loan consumed 36 percent of the average borrower's gross paycheck, requiring them to renew their loans or take out an additional loan. Pew stated that 75 percent of all loans went to individuals who had at least 11 loans per year.

The industry has also been accused of targeting minorities and the poor. For example, the Howard University Center on Race and Wealth published a study in December 2014 that examined payday lending in Alabama, Mississippi, Florida and Louisiana. Here are some key findings included in the report.

• In Alabama, 976 of the state's 1,032 payday stores were located in areas having median household incomes of $20,000 to $60,000. In areas where the minority population was at least 20 percent, there were 967 stores.
• In Mississippi, there were 898 deferred presentment providers, all of which were in areas having a minority population of at least 20 percent. For example, one area had 18 stores and a population in which African Americans accounted for 46 percent of the total. Another area had 23 payday stores and a minority population of 64 percent.
• In Florida, payday lenders tended to choose locations where residents had incomes of approximately $40,000. Out of 1,277 stores, 1,200 were found in areas in which the population was as much as 60 percent Hispanic and over 30 percent African American.

However, numerous researchers have found little correlation between a neighborhood's ethnic and racial composition and the prevalence of payday lenders. For example, a study published by the Federal Reserve Board found that lenders chose locations based on the economic characteristics of the neighborhood's population, undermining charges that lenders ignore economic conditions to deliberately place stores in minority neighborhoods. Instead, lenders are choosing neighborhoods where the people who are most likely to use their services work or live.

Furthermore, various federal agencies have been involved in programs that targeted payday lenders. One of the most notorious was dubbed Operation Choke Point, an initiative of the Department of Justice that investigated banks and an assortment of businesses that could be potentially be involved in money laundering or fraud. Payday lenders were lumped in with escort services, gun and ammunition sellers, Ponzi schemes, dating services and sellers of drug paraphernalia. When the operation became public, it was soundly criticized. Some of the criticism claimed that the operation bypassed due process by limiting the companies' access to capital without first showing that they were violating any laws. Other critics called it an "ideological attack" on industries that the Obama administration did not like. After several hearings, the operation was effectively ended in 2015, but the Department of Justice did not announce its official end until 2017. While the operation was underway, numerous payday lenders found their banking relationships terminated simply because of their industry classification.

Industry supporters argue that the higher risks faced by short-term lenders justifies the higher rates. Furthermore, view their fees as an annualized percentage rate is meaningless; most loans are meant to be retired in less than 30 days. Supporters have also taken exception with claims by critics that lenders deceive borrowers into taking the loans; repeated studies have proven that most borrowers understood the terms clearly and knew how long it would take for them to actually repay the loan.

Industry Regulation on the National and State Levels

Historically, payday lending has been regulated at the state level rather than the federal level. In fact, the federal government has limited power when it comes to payday lending. The CFPB is basing its authority over the industry on the Dodd-Frank Act's prohibition of deceptive, abusive or unfair acts and practices by lenders, service providers and collection agencies. Although the CFPB can suggest caps on interest rates, the agency has no authority to order lenders to keep interest rates below a certain level or to define what constitutes usury.

However, the federal government chose to pass the Military Lending Act after a study by the Department of Defense revealed that financial problems could affect military readiness. The MLA caps interest rates at 36 percent APR for personnel on active duty as well as their spouses and dependents.

Regulations have been more successful at the state level. Some states have chosen to enforce existing usury statutes, while at least one state has banned payday loans under racketeering laws. Other states have simply allowed existing laws to expire that had granted the industry temporary exemption from usury statutes. It should also be noted that the information provided below reflects state statutes as of September 2016.

Small-dollar loans requiring a lump-sum repayment and giving the lender access to the borrower's bank account electronically or in the form of a postdated check are prohibited outright or effectively prohibited by caps on interest rates in 14 states as well as the District of Columbia. These states are:

- Arizona
- Arkansas
- Connecticut
- Georgia
- Maryland
- Massachusetts
- New Hampshire
- New Jersey
- New York
- North Carolina
- Pennsylvania
- South Dakota
- Vermont
- West Virginia

Short-term, small-dollar loans are legal in 32 states. Some states passed legislation authorizing these types of loans, deregulated interest rate caps or simply allow the loans under older statutes. However, some states have passed laws regulating the maximum loan amount, number of times a loan can be renewed or the repayment terms.

- Alabama
- Alaska
- California
- Delaware
- Florida

- Hawaii
- Idaho
- Illinois
- Indiana
- Iowa
- Kansas
- Kentucky
- Louisiana
- Michigan
- Minnesota
- Mississippi
- Missouri
- Nebraska
- Nevada
- New Mexico
- North Dakota
- Ohio
- Oklahoma
- Rhode Island
- South Carolina
- Tennessee
- Texas
- Utah
- Virginia
- Washington
- Wisconsin
- Wyoming

Three states have taken a hybrid approach that permits payday lending at a reduced cost.

- Colorado requires lenders to set loan terms of at least six months if repayment is based on deferred-deposit checks. The annual interest rate is capped at 45 percent, but lenders can charge a 7.5-percent monthly maintenance fee. Borrowers can repay loans in one lump sum or through installments.
- Maine sets the maximum interest rate at 30 percent, but the state allows tiered fees that can generate an effective APR of as much as 261 percent.
- Oregon permits interest of 36 percent on a one-month minimum term loan, but lenders can charge initial loan fees of $10 for every $100 borrowed. This results in an annualized percentage rate of up to 154 percent for the initial loan, but any subsequent loans will be at 36 percent.

The Current State of the Industry and Its Future

Unquestionably, the short-term, small-dollar loan industry is facing some major challenges in the coming years. An increasing number of lenders are turning to online loans or crafting new products that will comply with the regulations proposed by the CFPB. Although several states are likely to make modifications to their laws that could have a detrimental effect on the industry, it is the sweeping changes that will result if the CFPB's regulations become law that pose the greatest danger to the industry.

The text of the new rules proposed by the CFPB covers more than 1,300 pages. The regulations are so complex and stringent that many credit unions and small banks do not believe that they could comply without absorbing a loss on every small-dollar loan that they issue. Here are some of the proposed rules that could spell the end of the short-term loan industry.

• Before approving a loan, lenders would need to make sure that the borrower could repay the loan without defaulting after allowing for living expenses and other financial obligations. Lenders would be required to verify the borrower's major obligations and income through a process known as underwriting.
• Lenders must verify the applicant's borrowing history. Generally, lenders must enforce a cooling-off period of 60 days between loans. During this period, lenders could make another loan if they verify that the borrower's finances have improved sufficiently that the second or third loan could be repaid without additional borrowing. After three consecutive loans, the lender cannot make another short-term loan to the same borrower for at least 60 days.
• In a 12-month period, borrowers could not owe short-term debts for more than 90 days.
• Borrowers cannot renew their loans more than twice. Renewals are only permitted if the principal is reduced with each loan, ensuring that the loan is paid in full by the due date of the third loan, or if the lender allows the borrower additional time to repay the loan without incurring additional fees.
• For loans having a duration between 45 days and six months, the CFPB proposal offers two approaches. The first caps the interest rate at 28 percent but permits an application fee of up to $20. The second approach requires the lender to ensure that each monthly payment does not exceed 5 percent of the borrower's gross monthly income.
• Before depositing a postdated check or initiating an ACH debit, lenders must notify the borrower three business days in advance. The lender would be required to obtain a new authorization from the borrower if two consecutive attempts were unsuccessful.

Payday lenders oppose the regulations, insisting that the additional costs involved with underwriting the loans, the burden of maintaining documentation and costs involved with monitoring an individual's borrowing history would eliminate the potential for the lender to earn a profit. If interest rates are capped at 28 percent or even 36 percent, lenders claim that they will no longer be able to offer these loans. Many analysts agree with the lenders; the industry has a high default rate and often makes loans to people with poor credit. As with any loan, the greater the risk that the lender is taking, the higher the interest rate. The Pew Charitable Trusts found that there were no payday lending stores in states that limited the interest they could charge to 36 percent or less.

In August 2017, the media began reporting that the CFPB was making revisions to its proposed regulations. The revised proposal narrows the scope of coverage somewhat. As originally proposed, a covered loan could be a short-term consumer loan having a term of no more than 45 days or a loan with a longer term having an APR greater than 36 percent and granting the lender permission to initiate transfers from the borrower's account. Reports indicate that the revised rules will only cover loans having terms of no more than 45 days. Without additional revisions, however, even this watered-down version has the potential to wreak havoc on the payday lending industry.

Some Closing Thoughts

The short-term lending industry has been living with uncertainty for years. The belligerent stance taken by the CFPB against the industry has generated confusion, trepidation and disquiet among lenders as well as their borrowers. Many consumers who need access to short-term credit are concerned about where they can turn if personal installment loans, cash advances and payday loans become unavailable. The irony is that an agency of the federal government appears to be determined to destroy a legitimate industry that offers a valuable product to millions of Americans every year.

However, it is also ironic that people who have actually taken out bad-credit installment loans, fast cash advances, online payday loans or another type of short-term credit product are perhaps the only group not calling for the industry's demise. In study after study, the majority of the borrowers reported that they were satisfied with their experience. When the CFPB solicited comments on the proposed regulations, over 98 percent of the comments praised the industry or reported positive experiences. Interestingly, the CFPB did not release this information until forced to do so by a request made under the Freedom of Information Act. Furthermore, according to the FTC, a miniscule 0.003 percent of the 3 million complaints it received in 2015 involved the payday lending industry.

Despite the fact that the industry fills a need, serves borrowers who are excluded from traditional financial services and contributes to the economy, state and federal agencies seem bent on destroying a legitimate industry. This is not to imply that the industry should not be subject to oversight. Any industry having the power to impact the financial health of the consumer should have to comply with certain rules and regulations. Banks, credit unions, investment firms, insurance companies, credit card issuers and payday lenders should all be held accountable for their actions. However, why should the payday lending industry be singled out for offering short-term, high-risk loans to those with the greatest need?