How a Multi-Billion Dollar Industry Helps Americans

A Simple Guide to Online Payday Loans

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Make Anyday Payday

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Introduction and Summary

Since the 1990s, payday loans[i] have grown into a multi-billion dollar industry in the United States, with no signs of slowing down anytime soon. These payday loans, sometimes referred to as payday or cash advances, act as convenient, short-term loans that help borrowers[ii] pay for unexpected expenses[iii] and avoid late fees or service charges. Given the easy access to payday loans these days, it's not surprising to learn that an estimated 19 million American households borrow payday loans each year (Center for Responsible Lending 2009). But who are these Americans? Consider these demographic characteristics of heads of households that use payday loans based on the 2007 Survey of Consumer Finance Data:

- The average payday loan borrower is 39 years old.
- 41% of borrowers are homeowners.
- 42% of borrowers are single women (Survey of Consumer Finance Data 2007).

An estimated **19 million** American households borrow payday loans each year.

Center for Responsible Lending 2009

The majority of payday borrowers are not poverty-stricken. They earn between $25,000 and $50,000, with 54% of them having either attended some college or graduated with a degree (Elliehausen and Lawrence 2001). Many people turn to payday loans because they are a quick cash resource and easy to apply for — in most cases, borrowers only need to prove that they have an active checking account, have been employed for at least one month, are a U.S. citizen or permanent resident and at least 18 years old. And unlike with traditional credit options such as banks or credit card companies, a borrower's credit rating[iv] is not as important as long as they meet the lender's requirements. But in order to fully understand the significance of payday loans and the impact that they have on American households, it's important to learn how they first came to be.

Back in the Day

Payday lending,[v] or deferred presentment lending as it was first known, broke through in the early 1990s when check-cashing firms discovered that they could earn extra money by providing their customers with a way to obtain money in advance of their paycheck. But because loan APRs[vi] were higher than what most states allowed, many states made payday lending illegal at the time. Check-cashing firms, of course, did not agree with the decision and voiced their opinions on how people wanted, and needed, quick access to money. As a result of the pressure put on the government by check-cashing firms and their customers, individual states began to gradually pass laws during the 1990s through the mid-2000s that allowed payday lending. By 1998, payday lending was legal in 32 states. Ten years later in 2008, it was legal in 37 states (Avery 2011).

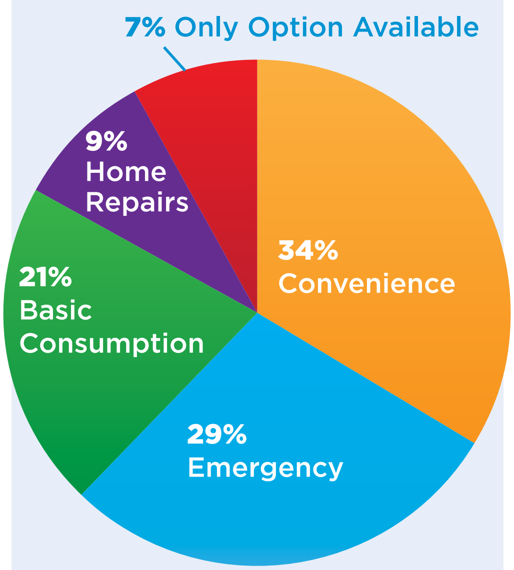
Just like payday lenders, pawnshops[vii] also provide people with a quick way to access money. As the payday lending industry grew during the mid-1990s, however, pawnshops suffered in terms of business. To counter, many pawnshops began offering payday loans to customers in their stores as they realized that the need for short-term credit was at an all-time high (Caskey 1991).

Today, payday lending has progressed onto the Internet and offers borrowers the convenience of applying for a payday loan from the comfort and privacy of their own homes. Instead of waiting in long lines at stores, borrowers can log onto their computers and complete an application in less than five minutes. Online lending pioneers such as CashNetUSA and Cash Central were some of the first lenders to offer payday loans online, taking a risk when the Internet was still in the early stages of its deployment.

Nearly **five percent** of the U.S. population has taken out a payday loan at some point in their life.

Stegman 2007

According to the Atlanta-based consulting firm Stephens Inc., nearly five percent of the U.S. population has taken out a payday loan at some point in their life, if not more (Stegman 2007). The Consumer Credit Research Foundation reports that nearly 24 million Americans, or about 10 percent of the adult population, admit that they are somewhat or very likely to obtain a payday loan in the future (Stegman 2007). Consider this — today, there are more payday loan and check-cashing stores nationwide than there are McDonald's, Burger King, Sears, J.C. Penney and Target stores combined (Karger 2005).



Why do people borrow from payday lenders?

Data taken from 2007 Survey of Consumer Finance

How a Payday Loan Works (In-Store and Online)

Sometimes referred to as a cash advance, a payday loan is a short-term loan that is usually repaid upon a borrower's next payday. In storefronts, borrowers have to provide a physical check as security for the payday loan. After filling out paperwork and providing several documents of verification, including a pay stub and bank statement, a borrower will receive their loan, provided that such borrower has been found eligible for such loan. On the loan's due date, the borrower must return to the store and repay in person. If he/she is unable to do so, the storefront may process the check normally or withdraw it from the borrower's checking account.

With online payday lenders, payday loans may be secured through the Automated Clearing House (ACH),[viii] the same process that employers use to deposit checks directly into their employees' bank accounts. When an online application is submitted, the lender will begin its review process and verify that all of the applicant's information is accurate — this could take as little as five minutes or up to a few days, depending on the lender and the information the borrower provides. Only once a borrower is approved is money deposited directly into their bank account and debited, along with fees, typically upon their next payday.

Why Borrow a Payday Loan?

Many people turn to payday loans because in certain circumstances, they may be a cheaper alternative to bouncing a check, paying various service charges or obtaining late fees for late bill payments. But there are other reasons as to why people borrow from payday lenders.

According to the 2007 Survey of Consumer Finance Data, 34 percent of borrowers took out a loan for the convenience factor, while 29 percent said they needed a loan to help pay for an emergency. Another 21 percent said it was for a basic consumption need, such as gas for their car, while nine percent said they used their payday loan for home repairs. The remaining seven percent admitted that it was the only option available to them. As the data shows, payday loans are used for a variety of reasons (Survey of Consumer Finance Data 2007).

So who typically qualifies for one? Technically, anyone who meets a lender's requirements can qualify for a payday loan. Although each lender has different requirements for applicants, in most cases, borrowers need to have an active checking account, be employed for at least one month, be a U.S. citizen or permanent resident and at least 18 years old in order to apply. Just because a borrower is eligible to apply, however, doesn't mean that they will actually be approved for a loan.

What to Look for in an Online Lender

With so many online lenders to choose from these days, borrowers can sometimes feel a bit overwhelmed when they first start looking. But by clearly defining which qualities are most important to them, a borrower can easily pick a lender that best suits their needs. Let's start with the most obvious: speed. Since payday loans are marketed as a "quick" solution to emergency expenses, they have to be fast. In most cases, a payday loan is deposited directly into a borrower's checking account by the next business day from the time they are approved for the loan by the lender, leaving them with plenty of time to pay upcoming bills, make a much-needed car repair or visit the grocery store. Borrowers should always look for a lender that can deliver their money in a timely fashion.

Another important element to consider are lender rates and repayment terms. In exchange for a payday loan, borrowers must repay the loan by their next payday, usually within two weeks, plus a fee. Top-rated lenders typically offer competitive rates that are in compliance with applicable state and federal law. Borrowers should also read their contracts thoroughly before signing — a responsible lender will always clearly outline their rates in accordance with the Truth in Lending Act.[ix] It's also important to have as many repayment options as possible. It may be that some lenders offer several repayment options and are willing to work with borrowers. It may be convenient to be able to request an extension or make a partial payment when a full payment can't be made.

It's also convenient to be able to contact a lender whenever an issue or question arises. While most online lenders only offer customer service Monday through Friday, some provide 24/7 support via phone, email or online chat. With how busy life can get at times, it's important to choose an online lender that is capable of handling any borrower's schedule.

The last quality to look for in a payday lender is whether or not they're licensed in the states that they do business in. One of the biggest mistakes borrowers make is to turn to unlicensed lenders for payday loans. Countless websites are operated by non-accredited, non-licensed payday lenders that claim to be safe, secure and trustworthy. And although many of these lenders will highlight their registrations and licenses, most are not state licensed as required by U.S. and state law and are likely operating outside of the country in order to bypass state regulations, which are designed to protect and support citizens of each state. By providing personal and financial details to these types of lenders, borrowers can fall victim to significantly higher fees as well as fraud,[x] identity theft[xi] and other various scams with fewer options for state support and consumer protection.

While these are some of the most important characteristics people should consider when choosing a lender, they're definitely not the only ones. Is the lender recognized by the Better Business Bureau?[xii] Does the lender protect its website with the appropriate tools, including McAfee SECURE™[xiii] and VeriSign Secured™[xiv] technologies? With so many payday lenders to choose from, it's important to examine each one carefully before making a decision.

My Online Lender Checklist

- [ ] Loan Amount
- [ ] Loan Fee
- [ ] Approval and Funding Speed
- [ ] Online Chat
- [ ] Customer Benefit Programs
- [ ] 24/7 Support
- [ ] State Licensed

Make a List and Check It Twice

Deciding on the perfect lender is no easy task. That's why it's always beneficial for a borrower to make a checklist to ensure that the lender they choose meets their expectations. With how overcrowded the online lending industry currently is, sometimes all it takes is a higher maximum loan amount, a lower lender fee or better customer service to choose one lender over another. Some benefite to consider are:

- loan amount
- loan fee
- approval and funding speed
- online chat
- customer benefit programs
- 24/7 support
- state licensed

Feelings Toward Payday Loans

Since the 1990s, payday loans have consistently been under attack by various organizations and members of Congress about the high costs associated with them. Some feel that payday loans put borrowers further into debt and offer no financial assistance. Others believe that payday loans are too complicated for borrowers and don't fully explain the risks associated with them. These claims, however, are inaccurate and unsupported according to a detailed economic analysis of consumer demand for, and the use of, payday advance services, released in 2009 by the George Washington University School of Business (Elliehausen 2009).

86%

Borrowers overwhelmingly appreciate payday loans, with **86 percent** of them saying it is a useful financial product.

Elliehausen 2009

The study found that borrowers overwhelmingly appreciate payday loans, with 86 percent of them saying it is a useful financial product. They also know how to use payday loans responsibly, with 71 percent of borrowers using payday loans as a way to cover unexpected expenses or temporary reductions in income (Elliehausen 2009). As mentioned earlier, one of the biggest issues organizations and members of Congress have with payday loans is their high costs. The study revealed that 95 percent of customers were aware of and accurately reported the finance charge associated with their loans (Elliehausen 2009). While critics will continue to take aim at payday loans and the industry as a whole, the customer data found in the study is contrary to what these critics claim.

Debunking Payday Loan Myths

With so many misleading payday loan reports circulating around the Internet these days, it's hard for a borrower to differentiate fact from fiction anymore. As a result, the Community Financial Services Association of America (CFSA)[xv] conducted a simple and honest examination of payday loans and the payday lending industry in an attempt to debunk all myths associated with payday loans. Here are a few:

> Myth: Payday loans are extremely expensive and have exorbitant interest rates.
> Reality: The average fee charged by payday lenders is $16 per $100 borrowed (Logan and Weller 2009). Many critics often cite that payday loans can have as high as a 391 percent APR, which is a bit misleading. Since payday loans are only two-week loans, the only way to reach that high of an APR is to roll the two-week loan over 26 times, which is not allowed anywhere (Community Financial Services Association of America).
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> Myth: Payday lenders target poor people.
> Reality: Most payday loan borrowers earn between $25,000 and $50,000 annually, with some borrowers even reporting incomes of $40,000 or more. The average age of a borrower is 39 years old and all borrowers have steady incomes and active checking accounts, both of which are required in order to apply for a loan. And since payday lending is a business when everything is said and done, its success depends on lending to borrowers who are able to repay their loans (Community Financial Services Association of America).
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> Myth: Payday lenders hide fees and mislead consumers.
> Reality: Borrowers won't find a more transparent loan product in the financial services industry than a payday loan. According to CFSA, 95 percent of payday loan customers said that they were aware of the fee associated with their payday loan. Borrowers are told their loan fee before they sign their contract to avoid any hidden surprises and can even return the borrowed amount to the lender within 24 hours with no interest charged (Community Financial Services Association of America).

These are just a few myths that the CFSA has debunked. To read more, visit http://cfsaa.com/about-the-payday-industry/myth-vs.-reality.aspx.

Conclusion

The growing use of payday loans in the United States is indisputable. The payday lending industry lent $8 billion in 1999 and more than $40 billion just five years later. By 2006, there were more than 25,000 payday loan storefronts around the country (Melzer 2009), and online lending was estimated to account for nearly $7.1 billion in loans during 2008 alone (Avery 2011). So what's the driving force behind such growth? The need for quick and accessible cash. Men and women of different ages and with different incomes have and will continue to turn to payday loans when other sources of credit turn them down or are simply more expensive. And with simple requirements such as an active checking account, being employed for at least one month, being a U.S. citizen or permanent resident and at least 18 years old, applying is easy, especially when done online. While there are critics who often misunderstand or misrepresent the payday lending industry, it continues to offer borrowers responsible and fair lending services. But more importantly, payday loans provide borrowers with something that is priceless — a sense of relief when the going gets tough.

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Glossary

[i] **Payday loans** – Short-term, small-principal loans that are usually repaid upon a borrower's next payday.

[ii] **Borrowers** – People who apply and are approved for a payday loan.

[iii] **Unexpected expenses** – Emergency costs not included in a person's day-to-day living, such as a car repair or plumbing bill.

[iv] **Credit rating** – An assessment of an individual's finances, including history of borrowing and repaying, assets and income.

[v] **Payday lending** – The act of covering a borrower's expenses until his or her next payday.

[vi] **APR** – The annual percentage rate (APR) that tells the interest rate of a specific item for an entire year.

[vii] **Pawnshops** – Businesses that offers loans to people in exchange for their personal property.

[viii] **ACH** – An electronic network for financial transactions in the United States.

[ix] **Truth in Lending Act** – A federal law enacted in 1968 that requires lenders and creditors to disclose the APR, term of the loan and total costs to the borrower.

[x] **Fraud** – An intentional act of deception intended to damage another individual.

[xi] **Identity Theft** – Stealing another person's identity and pretending to be them.

[xii] **Better Business Bureau** – A corporation that collects information on business reliability and informs the public about ethical business practices.

[xiii] **McAfee SECURE™** – A security tool used by websites to protect customer information.

[xiv] **VeriSign Secured™** – Another tool used by websites to secure Web servers.

[xv] **CFSA** – A national organization established to promote laws and regulations that protect consumers while preserving their access to credit options.