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Introduction

Chairman Nelson, Ranking Member Collins, and Members of the Committee, thank you for the opportunity to provide you an overview of the Consumer Financial Protection Bureau's recently released white paper on payday loans and deposit advance products.[1] This is perhaps the largest study to date on the short-term, small-dollar loan market. With this paper, the Bureau endeavored to provide a shared set of facts from which stakeholders of all types could engage in conversations with the Bureau on issues related to short-term, small dollar loans. What the Bureau has found is that too often consumers are getting caught in an extended and costly period of debt, likely as a result of chronic cash flow shortages.

Background

Payday loans and deposit advance products are small dollar loans often described as intended for use to cover unexpected expense or to bridge a temporary gap between paychecks. Payday loans are offered by non-banks and deposit advances are offered by a small number of depository institutions to their customers with deposit accounts. Lenders typically describe the cost of these products as a fixed fee per dollar borrowed; most commonly $15 per $100 for a payday loan and $10 per $100 for a deposit advance. Since most payday loans have a fixed due date, they are treated as closed end loans under federal law and lenders also are required to disclose the APR; there is no similar requirement for deposit advances which are structured as open-end lines of credit. Repayment for such services is timed to the borrower's next regular receipt of cash, which is most typically a paycheck, but may also be from unemployment insurance, social security benefits or, in the case of deposit advances, other electronic deposits.

In January 2012, the Bureau added payday lenders to its supervision program on top of its existing efforts to supervise the depository institutions that offer deposit advance products. We also held a field hearing in January 2012 in Birmingham, Alabama, to hear directly from consumers and providers of these products. At that time, the Bureau began its study, which resulted in our white paper, issued in April of this year. The purpose of all our outreach, research, and analysis is to help better understand the best approach to protect consumers while ensuring that they will have access to a small dollar loan market that is fair, transparent, and competitive.

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1 CFPB's Payday Loans and Deposit Advance Products report can be accessed at http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

The Bureau's study found that payday and deposit advance loans, while designed for short-term or emergency use, are leading many consumers into long-term, expensive debt burdens. For far too many consumers, payday and deposit advance loans are traps. Returning every two weeks to re-borrow the same dollar amounts at a high cost becomes a drag on the financial well-being of consumers already facing income shortfalls.

Overall, the Bureau found that a substantial percentage of consumers using either payday loans or deposit advances do so in a frequent and sustained way. Loans are often taken in rapid succession, with borrowers in nearly continuous debt, which is especially true for heavier users.

Key Findings

The Bureau's payday findings were developed from information obtained from a number of storefront payday lenders over a 12-month period. For each account with activity in the first month of the study period, we studied all activity over 12 months. Our deposit advance findings were developed from information obtained from depository institutions offering this product. For this group, we examined for a 12-month period, a random sample of accounts that were eligible to receive a deposit advance during the first month of our study or during the quarter prior to the start of our study.

Allow me to summarize some of the Bureau's key findings.

We found that a fairly small segment of consumers use payday loans or deposit advances on an occasional basis. For example, 13 percent of the payday borrowers in our study took out only 1 or 2 loans over 12 months. Eighteen percent of the deposit advance borrowers obtained total advances of $750 or less.

However, a much larger group of consumers use payday or deposit advance on a sustained basis. Forty-eight percent of payday borrowers took out 11 or more loans and 52 percent of deposit advance borrowers obtained advances totaling $3,000 or more. Fourteen percent of payday borrowers had 20 or more loans and the same percentage of deposit advance borrowers were advanced more than $9,000.

Many of these loans are taken out on a nearly continuous basis, particularly for consumers who take out seven or more loans or obtained more than $3,000. Most frequently, new loans are extended the same day or within a week or two of a prior loan being paid back. These consumers are unable to get to the next paycheck or the next regular infusion of cash without borrowing again.

While most consumers report income from employment, 18 percent of payday borrowers report public assistance rather than employment as their source of income. These consumers are more highly concentrated towards the lower end of the income range than consumers with income from employment.

Although payday loans and deposit advances are often described as tools to enable consumers to avoid incurring overdraft fees or bouncing checks, in our deposit advance study we were able to observe the relationship between the use of deposit advances and the incidence of overdraft and nonsufficient fund or NSF fees. The Bureau found that 65 percent of consumers in our study sample who took out a deposit advance also incurred at least one overdraft or NSF fee. This percentage increased as the usage of deposit advances increased, from 45 percent of light users to 83 percent of heaviest users. Similarly, the number of overdraft or NSF fees also increased with overdraft usage from a mean of seven for light users to a mean of 16 for heaviest users.

The Bureau is concerned that many consumers use these high-cost products in a sustained way. Lenders currently do not assess whether a borrower can afford to repay a loan and the fees while meeting their other expenses. Due to the fact that the entire loan amount is generally repaid or due to be repaid in each pay cycle, it appears to be hard for many consumers to repay the loan and meet other expenses without experiencing another short-fall, taking out another expensive loan, and/or overdrawing an account. Financial products that trigger a cycle of debt can exacerbate the precarious balance of consumers' financial lives.

Next Steps

The Bureau white paper underscored that consumer protection issues exist in the small dollar loan market, and that further attention to these products is warranted. The Bureau intends to continue its study of small dollar loan products to better understand why some consumers are able to use these products in a light to moderate way, while others seem to get trapped in a prolonged borrowing cycle. The Bureau would also like to better understand the effectiveness of limitations that have been put into place by state laws, trade associations, and institutions to curb the sustained use that can lead to adverse financial consequences for consumers.

As the Bureau looks to next steps, we will consider how best to exercise our authorities to protect consumers while protecting access to affordable credit. There is a demand for small-dollar credit products, which can be helpful at times for consumers who use them on an occasional basis and can manage to repay them. As Director Cordray has said, "the Bureau will work to make sure that consumers can get the credit they need without jeopardizing or undermining their finances. Debt traps should not be part of their financial futures."

Finally, I would like to thank the Committee for its continuing work to protect older Americans. Protecting older consumers' financial well-being is also one of the Bureau's important missions. Our Office of Financial Protection for Older Americans is working to help the approximate 55 million consumers age 62 and older lead safer, more productive financial lives. As the older population is expected to dramatically increase in the next two decades, we are likely to see an increase in the number of older consumers facing financial challenges. Among other things, unlike their younger counterparts, older consumers have less time to recover when they suffer a financial loss; are more often victims of fraud; are at higher risk for cognitive impairment, which can diminish their ability to make financial decisions; and, according to a Federal Reserve survey, three out of five families headed by a person 65 or older had no money in retirement savings accounts. And, these are just a few of the reasons why many older Americans are financially at risk.

Chairman Nelson and Ranking Member Collins, thank you for the opportunity to share the Bureau's findings. I am happy to respond to your questions.