Drowning in Debt

Are Credit Unions Helping Combat Payday Lenders or Contributing to the Problem?

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Table of Contents

Introduction/Statement to the Issue **2**
Research **5**
What Is Payday Lending 5
History of Payday Lending 5
Who Uses Payday Loans 6
Why Our Borrowers Use Payday Loans 7
Payday Loan Alternatives 8
Case Study: BayPort Credit Union 10
Credit Union Statistics 15
Legislation/Regulations 19
Recommendations/Solutions **22**
Summary and Conclusions **28**
Individual Conclusions 29
Bibliography **32**
Appendix A: Credit Union Alternatives to Payday Lending Survey **35**
Appendix B: Credit Union Alternatives to Payday Lending Results **37**
Appendix C: Payday Loan Usage by Demographic and Geography **39**
Appendix D: Additional Information on Recommendations and Solutions **41**

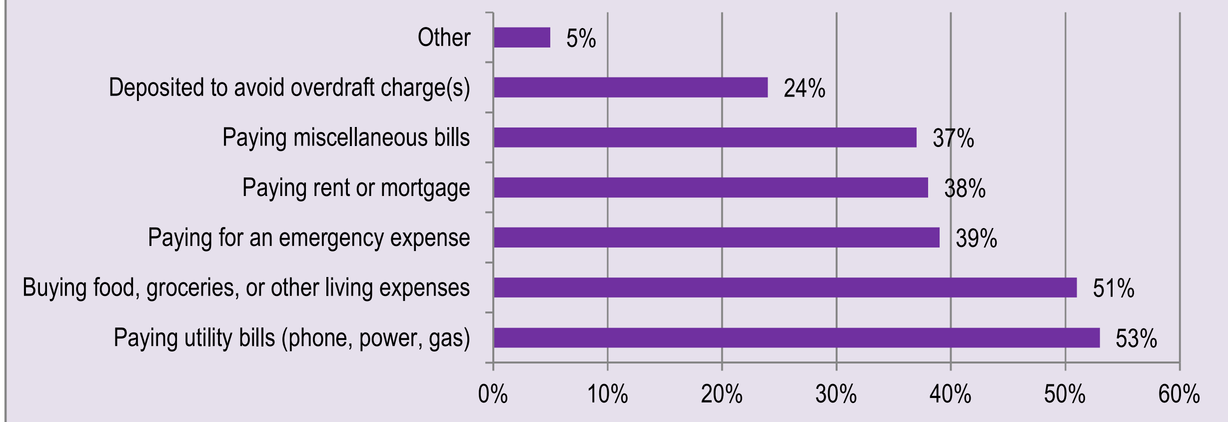
I. Introduction/Statement of the Issue

Payday lending is a practice that often leads to negative consequences for many Americans, inspiring credit unions to offer cost-saving alternatives and financial education.

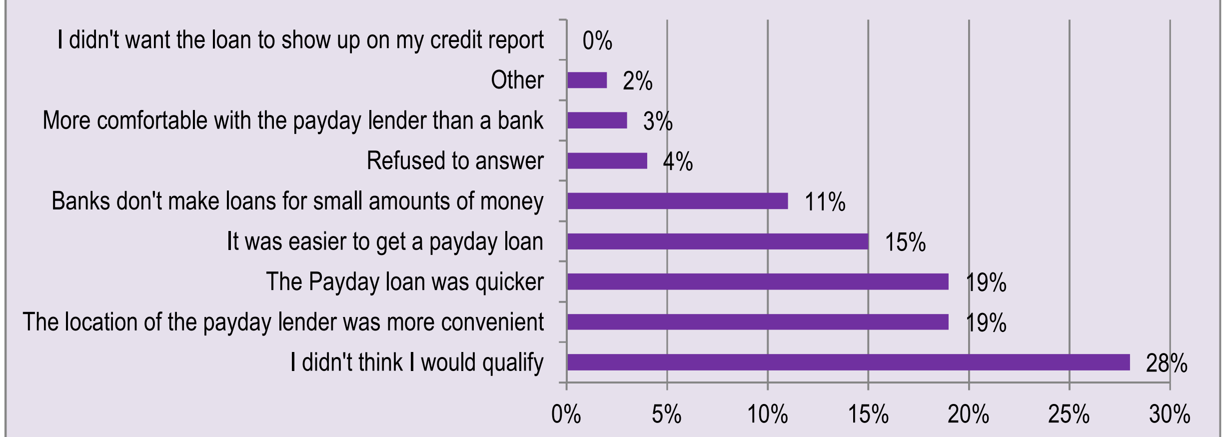
We have chosen to research payday lending in America as it is a significant topic that has long been a concern among credit unions. The aim of our paper is to determine if credit unions are helping combat payday lending or contributing to the problem. Credit unions differentiate themselves from predatory lenders because we are non-profit, community-oriented, and exist to serve our members in a cost-effective manner. Credit union employees understand that their role is to help people by providing competitive rates and other financial services to members that may not be otherwise available to members. Credit unions approach situations much differently than a payday lender would because we are non-profit.

Many credit union members are unaware that we already offer products and services as alternatives to payday loans. In 2015, credit unions provided $134.7 million in payday alternative loans, saving members from triple digit rates and excessive fees that they would've incurred from predatory lenders (NCUA.gov). But, by offering a similar product, the questions remain: Are credit unions any better than payday lenders? Are we really helping our members break the cycle?

In a society where many families are living paycheck to paycheck, it's no shock that our nation is struggling with a predatory lending epidemic. An amazing 12 million Americans used payday lending services in 2010! Why are so many people resorting to these services? Fear, desperation, and embarrassment are a few of many reasons. When the rent or mortgage is paid and the groceries are purchased, many Americans are left with a deficiency for the rest of their pay period. Other expenses such as utilities, gas, daycare, car loans, and unplanned auto repairs may remain unpaid. Forty-seven percent of Americans say they do not have enough money saved to cover a small emergency such as car repairs and medical bills. For someone with low income and imperfect or limited credit, turning to a payday lender may seem the best available option. However, what they do not realize is that by the time their loan matures, their monthly bills are due again and they are often forced to take out another loan, thus beginning a vicious cycle that can seem impossible to escape. Figure A shows the most popular reasons people turn to payday lenders in a survey given by the Federal Reserve.



For many, the quick turnaround and minimal qualifications are the two most appealing factors of turning to payday lenders. Generally, you must have a monthly income of $1,000, a valid home address, a checking account number, a driver's license, social security number, and copies of your most recent paystubs to verify employment, wages, and pay dates. Borrowers are often exploited through their vulnerability, unsophistication, and poor credit. These loans are characterized by higher interest rates and hidden fees, as well as abusive terms and conditions. Ultimately, due to these terms and fees, these loans lead to increased indebtedness. An amazing 98% of payday loans are to repeat borrowers with the average borrower paying $800 to borrow $325! Through deceptive acts, coerciveness, and exploitation, borrowers are not aware of this up front when they initially complete their transaction. As of November 2014, there were over 20,000 payday lenders located across the country, according to the St. Louis Federal Reserve. That's more locations than McDonald's or Starbucks! Their many locations and extended hours also offer borrowers convenience over a bank loan or credit card. Figure B depicts specific reasons members made these choices according to a survey recently conducted by the Federal Reserve.



Credit unions operate under the philosophy of “people helping people.” While many are not aware, credit unions already offer various alternatives and educational items to help our members, including financial counseling, high school financial literacy programs and branches, overdraft protection, and lower interest loans (Quick Cash). Unfortunately, some may be afraid of rejection and embarrassment, assuming they wouldn’t qualify for a traditional bank loan. To avoid rejection, they turn to payday lenders to relieve their financial burdens quickly. They would rather pay the higher interest than admit their struggles and risk being judged or questioned. With half of the US population having less than $500 in savings, it’s a reality that sometimes people rely on payday lenders when in a quick financial pinch (Baradaran 2016).

In this paper, we will explore the history of payday predatory lending and how it has grown and evolved over the years. We will take a closer look at how borrowers are attracted to these lenders and how they often become trapped by them. Current and possible solutions will be reviewed to help determine if credit unions are helping combat this widespread epidemic or if we are contributing to the problem. By probing past and current regulations surrounding payday lending, we will see if they have had positive or negative implications on the payday lending industry and determine if credit unions are able to eliminate these unscrupulous lenders.

II. RESEARCH

What is Payday Lending?

Payday lending is defined as the unfair, deceptive, or fraudulent practice of lending by imposing unfair and abusive loan terms to borrowers. Typically, a lender offers a short-term loan where individuals can borrow a small amount at a very high rate of interest. The borrower writes a post-dated personal check in the amount they are borrowing, plus a fee, in exchange for cash. The payday lender then holds onto the check and cashes it on the agreed upon date, usually the borrower's next payday. Lenders will sometimes not require physical checks; rather they have the borrower allow access to their checking account electronically. While these loans are designed to be repaid by the following payday, they are often restructured when borrowers are unable to repay within the agreed upon term. They are then renewed or rolled over into a new loan with additional fees and interest. Payday lenders have finance charges ranging from $10 to $30 for every $100 borrowed. It is not uncommon for the annual percentage rate (APR) to be around 400%; it's easy to see how damaging this type of loan can be to a borrower.

"If you think nobody cares if you're alive, try missing a couple of car payments." – Earl Wilson

History of Payday Lending

Prior to the 1980's, it was a rarity to find a payday lender within the United States. Though their existence was rare, that's not to say that predatory lending was not an issue. As early as the Great Depression, loan sharks existed to aid desperate borrowers by accepting post-dated checks that allowed them to purchase the wages of their borrowers. According to the Consumer Federation of America, these predatory lenders charged rates of up to 1000% during this bleak time in history. Newspapers called their practice "loan sharking" because lenders employed the same ruthlessness as the ocean's great predators. In addition to loan sharks, pawn shops were also an option for people who found themselves down on their luck with limited options for obtaining cash assistance.

Fast forward to the late 20th century – brick-and-mortar payday loan stores began appearing in underserved areas. At the beginning of the 1990s, there were fewer than two hundred payday loan offices nationally! Very similar to the loan sharks of the previous years, they had borrowers providing them with post-dated checks to cover loan repayments plus their fees. Rather than loan sharking becoming outlawed, it simply moved out of the shadows, becoming normalized and accepted. By using terms such as "check cashing" versus "loan," they were able to avoid violating on state

usury laws. Intimidation was a common tactic with borrowers for repayment. The fear of being prosecuted for passing bad checks caused them to pay the high charges.

The 21st century brought an increase in predatory lending. By mid-2001, the number of payday loan offices had risen to about 10,000. Many of these were part of large multi-state chains. In a recent annual financial report, Advance America wrote, “We believe that the principal competitive factors are customer services, location, convenience, speed, and confidentiality.” Nowhere in their statement was price mentioned. Their popularity was not dependent on low fees; rather it was reliant on several other factors, convenience and speed being two of them.

Who Uses Payday Lending?

Twelve million Americans use payday loans annually, accessing both storefront and online lenders. The typical payday borrower is white, female, and between 25 to 44 years old. After researching other characteristics of payday loan users, there are five groups that have high odds of using these loans: (1) those without a four-year college degree, (2) African Americans over all other ethnic groups, (3) renters, (4) those earning below $40,000 annually, and (5) those separated or divorced. While most would associate lower income with the likelihood of payday loan usage, other factors can be more predictive of payday lending than income.

A study conducted by Pew Charitable Trust looked at usage by demographic. In this study, borrowers ages 25 to 29 have used payday loans at a higher rate than the general population. By contrast, loan use is below average among ages 18 to 24 and those 50 years old and older. Borrowers without a four year degree are much more likely to use payday loans than those with a degree. However, among those without a four-year degree, further differences in education level do not correspond with significant differences in payday loan usage. African Americans are more than twice as likely as others to have used payday loans even though they make up less than a quarter of all payday borrowers, as compared to whites who make up 55% of all borrowers. Renters have used payday loans at more than double the rate of homeowners. The difference in usage between renters and homeowners is consistent over all age categories. Households with incomes less than $40,000 are almost three times more likely to have used payday loans than those households with incomes of $50,000 or more. While almost every income group has used payday loans, the income earnings with the most usage of payday loans are those between $15,000 to $25,000. The percentage of separated or divorced borrowers especially those with children is almost twice that of all other borrowers.

This study also looked at usage by geography. It shows certain geographic areas reveal higher payday loan usage than others. Payday loan usage is the highest in the South and Midwest Regions of the United States. The West and Northeast Regions have the fewest percentage of payday loan usage. Oklahoma and Missouri are the leading states for payday loans. A major factor in the variation of payday loan usage in certain regions is the difference in how states regulate these loans. There are three examples of state law types for payday loans: permissive, hybrid, and restrictive. Permissive permits single-repayment payday loans with finance charges and interest not to exceed 75% of the borrowed principal. Hybrid

permits single-repayment payday loans with fees of 10% of the borrowed principal, along with a $5 fee for borrower verification with a state database of payday users. Restrictive does not permit payday lending or has price caps low enough to eliminate payday lending in these states. (Refer to Appendix C)

Why Our Members Use Payday Loans

Most borrowers use payday loans to cover ordinary living expenses over the course of months and not for unexpected emergencies over the course of weeks. When you think of payday loans, you think of a short term solution for an unexpected expense such as a vehicle repair, or emergency medical need. However, the average borrower uses a payday loan to cover recurring expenses such as rent, mortgage payments, utilities, credit card payments and food. Only 16% of payday loans are used to deal with an unexpected expense.

The average borrower has a loan five months of each year with each loan lasting an average of eighteen days. This is a sharp contrast with the conventional image of payday loans, which are advertised as short-term, small dollar amounts intended for emergency or special use. The financial industry and regulators suggests that using payday loans for recurring expenses is not an effective use of high-cost credit and such credit should be used to cover unexpected expenses for a short period of time. However, all research makes it clear that the typical borrower uses a payday loan many times per year and much of the borrowing comes in relatively quick succession once a person starts using payday loans.

Borrowers have given several reasons as to why they use payday loans:

- To pay rent or mortgage
- To pay for food and groceries
- To pay a regular expense, such as utilities, car payment, credit card bill, or prescription drugs
- To pay unexpected expenses, such as car repairs or emergency medical expenses
- To pay for something special, such as vacation, entertainment, or gifts

When trying to analyze why people borrow from payday lenders, there are two separate questions. First, why do people borrow $100 to $500 just a short time before their next paycheck? Second, why do people use payday lenders rather than seeking an alternative?

Payday lenders state most of the people that use payday loans have almost no money in their bank accounts and they have expenses that need to be paid. Most of these situations arise because of an unexpected expense, unexpected reduction in income, or poor budgeting habits. Once a borrower has a payday loan, they will have to borrow for several more pay periods before having the funds to repay the principal and meet other obligations.

Another reason payday lenders state borrowers use payday loans is that they have no better alternative. Borrowers are seeking to solve an immediate need for $200, and banks do not make small loans. Most credit unions do, but generally for members able to pass traditional credit screening criteria. Almost all financial institutions, banks and credit unions, offer small loans through credit card advances and/or lines of

credit on checking accounts. However, these options are not open for people who do not have credit cards or overdraft protection on their checking accounts and have flawed credit history. Even if a payday loan borrower has a credit card or overdraft protection on their checking account, they may have reached their credit limit and cannot receive additional funds using these methods. While some payday loan borrowers may have adequate credit history or own their own home and may be able to obtain an unsecured personal loan or home equity loan from a bank or credit union, these loans may require a larger loan advance amount than the borrower wants and it could take several days to process. Most payday loan borrowers do not have the time to wait for the loan to be processed as they are in need of the funds immediately.

Some payday loan borrowers that need $200 - $300 before payday could ask a family member or friend for short loan. However, payday lenders state these borrowers prefer to use a payday loan for the funds needed rather than reveal their financial situation to their family or friends. In some instances, the borrower has already exhausted this option of an informal alternative to the payday loan.

Other options for borrowers needing a payday loan to cover a $200 - $300 need before payday is to make a payment using a check that the borrower knows will not be paid because of insufficient funds in the account, or to delay making a payment obligation, such as rent or a utility bill. This alternative can be very costly. Financial institutions usually charge a $20 to $40 fee for each check that is insufficient, and the company receiving the insufficient check for payment also charges a fee of $20 to $30 for a "returned check". Even if the financial institution honors the insufficient check there is an overdraft fee assessed to the account and in some instances the account can be closed for frequent insufficient activity. Also, utility companies, landlords and other companies charge financial penalties for late payments. Most borrowers feel the cost of the payday loan is lower than the cost of returned check fees, late fees on rent or mortgage payments, or late payments on consumer debt obligations.

The average payday loan borrower states the primary reason they use a payday lender is the speed and ease of the transaction. Other reasons cited for using a payday lender are convenient locations as opposed to other alternatives and the fact the payday lender does not report the loan to a traditional credit agency.

Payday Loan Alternatives

Regardless of how payday lenders are viewed it is agreed that they charge above market rates of return. Should consenting adults be allowed to take out these loans that are inherently exploitative transactions? Are these consumers knowledgeable of the type transaction they are getting into and how it adversely affects their household income?

> *"As Americans, we don't mind seeing folks make a profit. And if somebody lends you money, then we expect you to charge interest on that loan. But if you're making that profit by trapping hardworking Americans into a vicious cycle of debt, you got to find a business model. You got to find a new way of doing business." – Barack Obama*

The twisted economics of payday lending cannot be separated from its predatory nature. This would be like the tobacco industry saying that smoking doesn't cause cancer. The harms of predatory lending are difficult to combat due to inadequate information about the scope of the problem. Consumers may not realize when they have been the victim of predatory practices; even those consumers who realize that they have been preyed upon are often reluctant or unable to report incidents to enforcement agencies. This is why the perils of predatory lending are difficult to track by enforcement agencies.

There are also divergent views on high cost loans to inexperienced borrowers. Consumer advocates focus on subprime lending and the increase in incidences in lending abuses whereas the financial industry argues that subprime lenders perform an invaluable service because they are lending to borrowers who have poor credit history and could not obtain credit elsewhere. Currently federal law limits the extent to which states can regulate lending practices. The Consumer Financial Protection Bureau announced in March 2015 that it was considering a set of rules for small dollar loans (up to $500) to be paid back within a 45 day time frame. This would also require lenders to make sure that borrowers could repay their loan and cover other living expenses without extensive defaults or re-borrowing. These actions seem to be a solution to curtail the possibility of people falling into debt traps with payday lenders. However, until mandatory regulation is put in place we will continue to see payday lenders on every street corner, robbing consumers of their hard earned dollar and negatively impacting our society.

As Credit Union advocates we are in the people helping people business. We are all cognizant that we should do something to help to curtail the payday lenders, who are also predatory in nature, but it's challenging to figure out a business model that works.

Missouri Credit Union Association CEO, Rosie Holub firmly believes that education is the key to combating payday lenders. She stated that "only when consumers are educated about the realities of predatory lending practices can they make sound choices."

Perhaps the best solution, until we all get a business model that works, is reaching out to our communities, our schools, and churches and providing them with financial literacy programs. If more credit unions would band together to provide financial counseling and educational seminars, and provide creative lending strategies to better assist borrowers we in turn create the beginning of a lifelong relationship where individuals can come and be a part of a trusted financial institution that puts their members needs first.

It is imperative that we teach consumers how to say "no" to credit solicitors, educate them on avoiding current scams as well as, teach them to manage credit and shop for good products and services. The topics on financial education are limitless but could all touch a consumer's life at one time or the other.

Case Study: BayPort Credit Union

In 2007, BayPort Credit Union (formerly known as Newport News Shipbuilding Employees Credit Union), responded to member needs by entering into the payday lending world. BayPort's core membership base included a large percentage of blue collar shipyard workers who were paid weekly and were prime targets for predatory lenders. BayPort's primary focus was to provide a lower cost alternative to the payday/predatory lender's high cost, short-term, pay advance loans. Their purpose and vision also included using the opportunity to educate members on good financial management and budgeting.

Program Structure

The original structure included two credit limit offerings that were similar in design. To be eligible, there was a minimum age requirement of 18 and members had to be with the same employer for at least six months with verification required. Once approved, there was no limit on on the number of loan advances as long as the previous one was paid off by cash or automatic transfer before taking out the next. These offerings expired after one year, at which time the borrower would need to reapply and requalify for these services. The following terms and conditions also applied:

	PayDay Cash $250	PayDay Cash $500
Annual Participation Fee	$35	$70
Verified Gross Monthly Income	$750	$1500
Interest Rate	18%	18%
Established member for:	90 days	One Year
Repayment Term	30 days	30 days

In addition, if the interested participant was in the process of filing bankruptcy or was not in good standing with the credit union, they would not be eligible for approval or future draws.

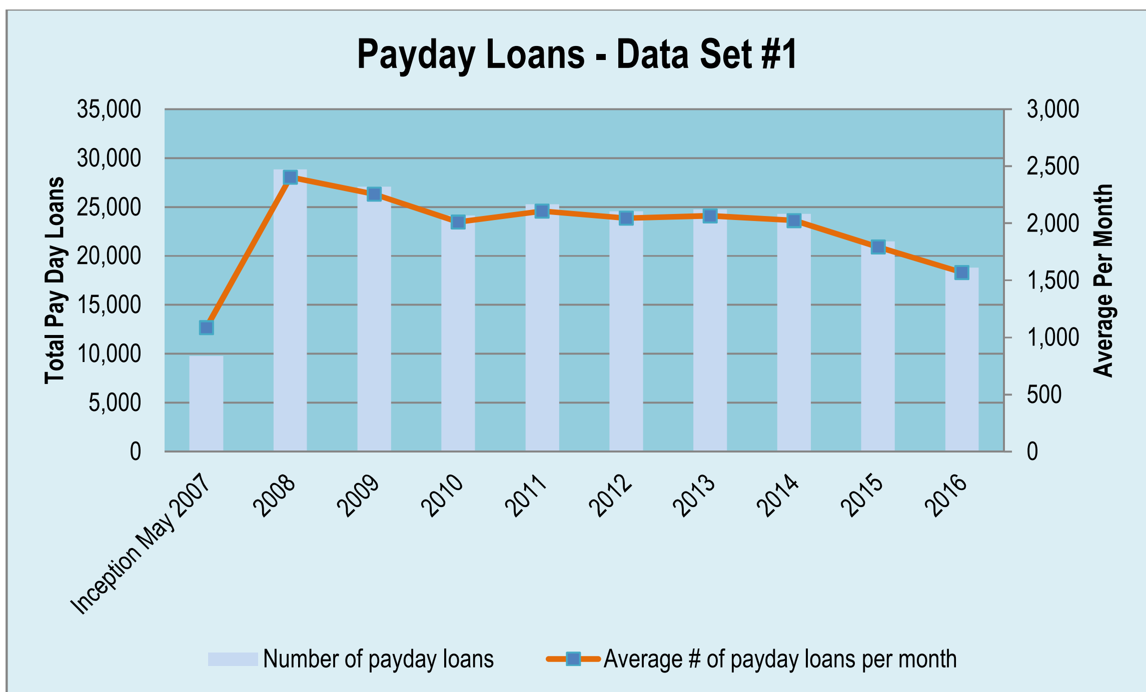
The payday lending program structure evolved over the subsequent years in response to compliance issues, internal audit recommendations to reduce charge-offs, and to limit abuse of the program. Some of the most significant changes/additions made included:

- Member required to have a direct deposit of at least $500 per month or entire net pay **3/1/2009**
- No delinquencies on any loans or credit card at the credit union for the previous 6 months **8/1/2011**
- Member must not be in a courtesy pay (ODP) repayment plan **1/30/2014**
- Member must have beacon score of 400 or better (If a member has a beacon score of "0", BayPort considers this a 600 for all consumer loans - **1/28/14**)
- Member is not active duty in the armed forces or a dependent **10/3/2016**

Use and Profitability

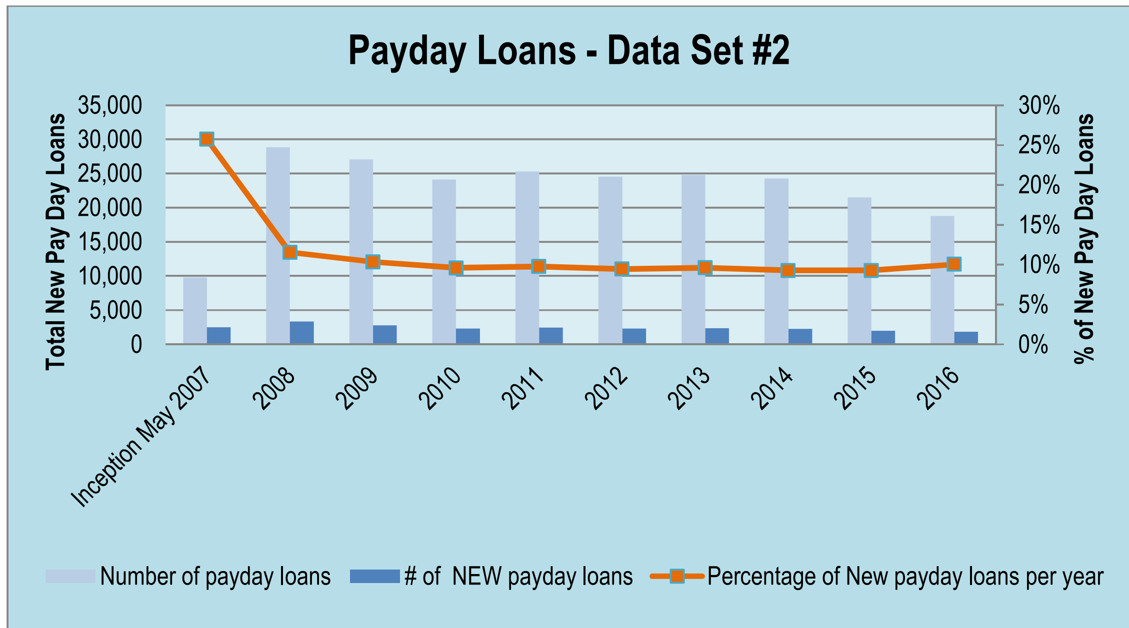
The historical data of the payday lending program at BayPort CU reflects the program has been successful in serving this segment of members and has been overall profitable. From inception thru 2014, BayPort logged a monthly average of approximately 2,000 payday loans. During 2015 and 2016, BayPort saw a decline in the number of payday loans with the monthly average dropping to just over 1,500 loans in 2016. From 2014 to 2016 the number of active payday loans dropped 22.5%.

Year	Inception May 2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Total Number of Payday Loans Per Year	9,772	28,848	27,051	24,134	25,273	24,540	24,777	24,289	21,500	18,821
Average Number of Payday Loans Per Month	1,086	2,404	2,254	2,011	2,106	2,045	2,065	2,024	1,792	1,568



The number of "new" accounts (no previous payday loan), have also followed the same trend as the overall program. After 2008 the number of "new" payday loans leveled off and saw sharper declines from 2014 thru 2016. From 2008 thru 2016 new payday loans have decreased 43%. However, in relation to how many payday loans were opened yearly, the percentage of new loans remained constant, hovering around 10%**.**

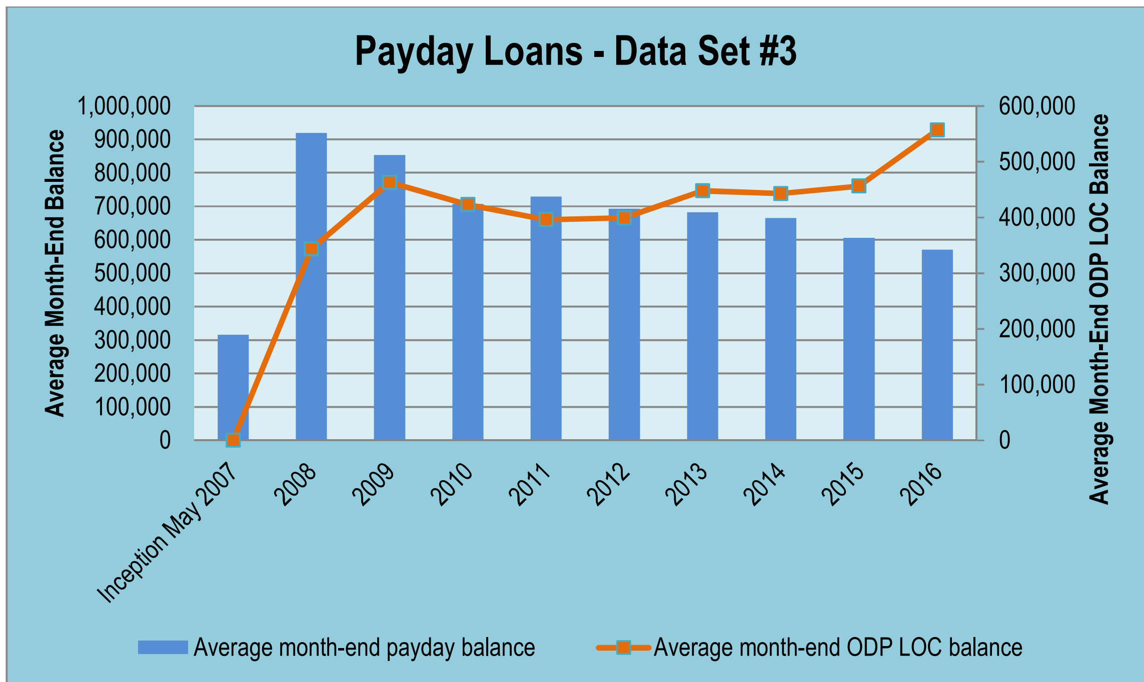
Year	Inception May 2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Number of Payday Loans	9,772	28,848	27,051	24,134	25,273	24,540	24,777	24,289	21,500	18,821
Number of New Payday Loans	2,515	3,329	2,797	2,315	2,471	2,321	2,381	2,257	1,995	1,890
% of New Payday Loans Per Year	25.7%	11.5%	10.3%	9.6%	9.8%	9.5%	9.6%	9.3%	9.3%	10.0%



The decline in payday loans could possibly be explained by analyzing a couple changes BayPort made in 2014 and 2015 involving the Courtesy Pay Overdraft Privilege (ODP) Program. In January of 2014, BayPort changed the payday lending criteria to exclude any members from getting a payday loan who were currently in an ODP repayment plan. Members had been "double dipping", using both products, resulting in higher charge-offs and/or more repayment plans. BayPort took action to help prevent members from getting trapped in a debt cycle by refining approval criteria for payday loans. In July 2015, BayPort changed ODP vendors, and as a result saw a significant increase in member use of ODP. The average month-end payday loan balances declined sharply after the implementation of these two changes.

Courtesy Pay programs have been viewed as a short-term loan by some regulators. Based on the trend illustrated below, it could be speculated that some BayPort members may be using Courtesy Pay (ODP) in lieu of payday loans. Even though there seems to be a correlation, there is no direct evidence that these changes caused a decrease in payday loans.

Year	Inception May 2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Average Month-End Payday Balance	$316,413	$919,577	$853,176	$707,410	$728,487	$692,453	$682,401	$665,183	$605,9266	$570,618
Average Month-End ODP/LOC Balance	$0	$343,507	$462,704	$422,828	$396,151	$399,228	$447,872	$442,842	$456,404	$556,902



Payday loans have yielded a small profit for BayPort Credit Union. Financial statements revealed that total income minus charge-offs equaled $1.8 million over 9.5 years. The yearly average profit was approximately $200,000. Charge-offs were relatively high for the first three years averaging 44%, and leveled off to approximately 20% for the remaining years. Modifications to the program helped reduce them significantly.

Income/ Charge-Offs	Total Since 6/1/2007	2016	2015	2014	2013	2012	2011	2010	2009	2008
Total Interest Income	$1,128,119	$103,329	$119,575	$119,575	$122,289	$124,934	$128,809	$125,190	$143,401	$149,206
Total Fee Income	$1,183,210	$103,925	$109,265	$123,585	$130,305	$129,535	$139,755	$130,025	$141,500	$175,315
Total Late Charges	$309,875	$26,429	$28,632	$32,206	$33,636	$33,858	$36,980	$36,110	$43,713	$38,311
Total Income	$2,621,204	$233,683	$249,283	$275,366	$286,230	$288,327	$305,544	$291,325	$328,614	$362,832
Charge-Offs	$794,021	$47,387	$48,819	$55,413	$52,377	$71,292	$85,601	$102,207	$186,196	$143,010
Total Income Less Charge-Offs	$1,827,183	$186,296	$200,464	$219,953	$233,853	$217,035	$219,943	$189,118	$142,418	$219,822

Since 1998, BayPort has had a full-time financial counselor on staff available to meet with members seeking help with debt management, understanding credit reports, and budgeting. In certain cases, members pursuing a payday loan may be referred to BayPort's financial counselor. These referrals often lead to success stories for members who follow through, but sadly few members do.

BayPort recognizes the problem runs much deeper than just being over-extended. Yes, they offer a low-cost, fair and competitive payday loan, but they believe "basic personal finance" needs to be revitalized. It needs to be learned at an early age in order to combat the true issues facing most payday borrowers today. After all, payday lenders cannot take advantage of someone who does not need the loan.

Over the past two years, BayPort opened 39 Student-Run Credit Unions and hired financial educators to be liaisons between the credit union and the schools. These financial educators are going into the schools and area businesses, teaching basic personal finance. Some of the successful programs being offered include Financial Football Camps for elementary and middle school students and Reality Fairs for the high schools. The students are excited and engaged. They are opening accounts and saving money. They are learning about budgets and credit scores, and how to manage their finances. After a recent reality fair, one student said, "I am going to go home and hug my parents. I had no idea how much it costs to live." This is confirmation to BayPort Credit Union that they are making progress in the financial education spectrum. Their hope is that the residual effect will be long lasting, and result in financially stable adults who will not need payday loans.

Credit Union Statistics

In partnership with CUNA, we reached out to our credit union colleagues to find out what credit unions are doing to help their members avoid the cycle of payday loans. Most credit unions responding to the survey stated they were aware there are members in their field of membership that fall into the cycle of payday loans. The main reason those members need the funds quickly is to pay large past due utility bills, repair a broken furnace, auto repairs, or rent. However less than half (35.71%) of credit unions surveyed offer an alternative loan product for payday loans. Of those surveyed, 14.29% stated that they do not currently offer an alternative to payday loans, but they have plans to start a program in the near future. (Refer to Table 1)

The average length of time credit unions have been offering an alternative to payday loans varies from less than a year (15%) to nine years (35%). The majority of the credit unions offering an alternative to payday loans have been offering this product to their member for three to five years (40%). (Refer to Table 2)

The terms and dollar amounts of these loans vary per credit union. The minimum term is 30 days and the maximum term is 180 days. Most credit unions charge a non-refundable loan fee of $25 - $30 for this product. Some credit unions require the applicant must be a member of the credit union for at least six months, have direct deposit and the loan amount cannot exceed the member's weekly income. The dollar amounts also vary from a minimum of $50 to a maximum of $1000. The minimum interest rate is 7.99% with a maximum rate of 28%. The number of times a member can receive this loan varies from one per year to a maximum of twelve per year. The one important difference to note between the credit union alternative and a payday loan is the alternative loan must be paid in full before a member can apply and receive an additional loan which means they cannot extend the term or payoff an existing alternative loan with the proceeds from a new loan.

Credit union members using an alternative payday loan tend to use this product over and over. Of the credit unions surveyed 68.42% stated the majority of their members that use this product are the same. (Refer to Table 3) Some credit unions stated this is the very reason they stopped offering an alternative payday loan, realizing that the same members were using the loan over and over and they were not helping the member get out of the cycle.

Do credit unions feel it is important to offer their members an alternative to payday loans? According to our survey results, 52% of the credit unions stated it is very important to offer an alternative to their members. (*Refer to Table 5*) While offering an alternative is very important to credit unions they also realized they need to provide programs for their members to get out of the cycle. Some ways credit unions are helping their members are through financial counseling (87.50%), requiring waiting periods between loans (33.33%), and graduating members to small lines of credit (25%). (Refer to Table 4)

Most credit unions offering an alternative to payday loans report they make a small profit on these loans (40%). While 20% of credit unions state they make a significant profit offering this type of loan alternative. (*Refer to Table 6*) The average income reported is approximately $200,000 over the last several years. Among credit unions offering at least one alternative payday loan product the average interest rate is 23%. The average number of loans in this area of their portfolio is 174 with the average amount totaling $74,679.

The average percentage of charge-offs is 1.26% or $3708.30. The average percentage of delinquencies is 3.47% or $2942.06. Most credit unions charge a non-refundable fee of $25 - $30 per loan.

Credit unions realize there is a segment of their membership that uses payday loans to help make ends meet. While not all credit unions offer an alternative payday loan product to their members they see the need to use other loan products and services in their portfolio along with counseling to help their members manage and break this debt cycle. Several credit unions stated they serve a low income population and have low income designation therefore they are committed to finding ways to help members get out of the payday loan cycle before it is too late.

TABLE 1- DOES YOUR CREDIT UNION CURRENTLY OFFER AN ALTERNATIVE TO PAYDAY LOANS TO YOUR MEMBERS?

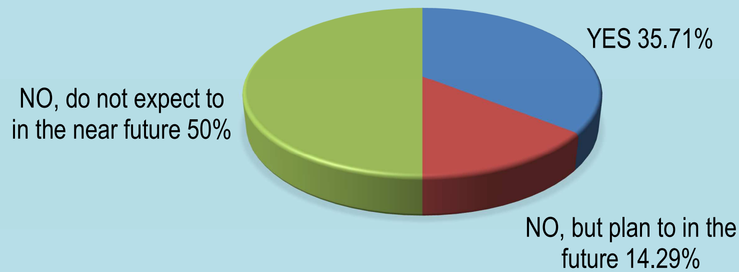


TABLE 2 - HOW LONG HAS YOUR CREDIT UNION OFFERED THIS TYPE OF LOAN?

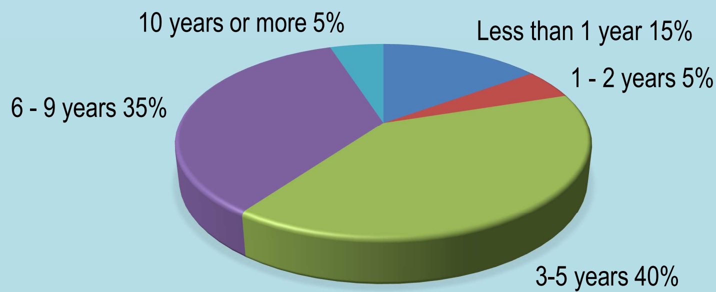


Table 3- Do the same members tend to apply for these loans over and over? (as often as allowed)

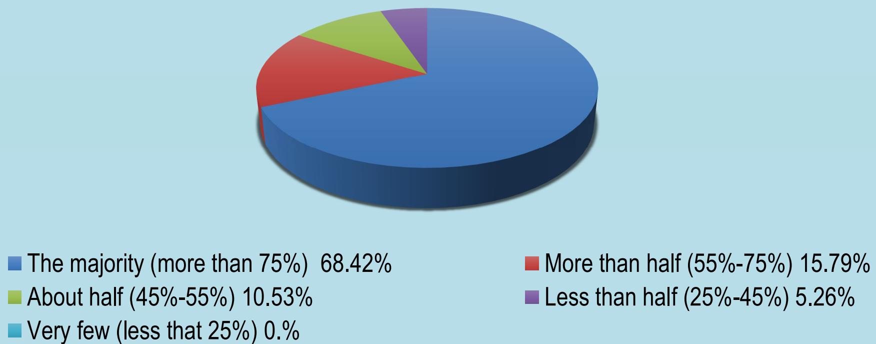


Table 4 - What type of programs does your credit union provide to help members out of this cycle?

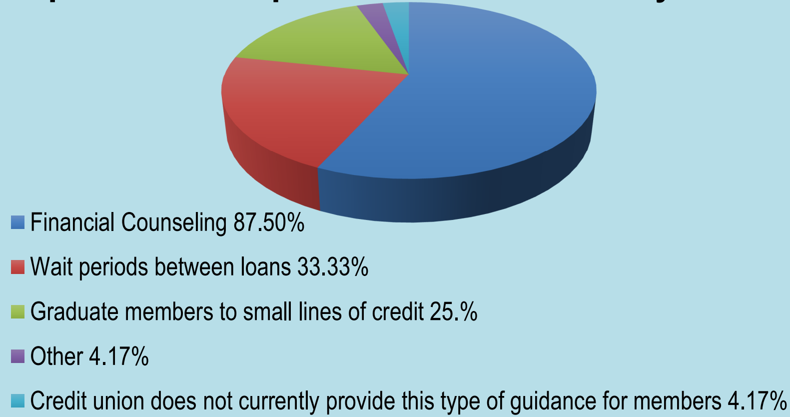


Table 5 - How important is it for your credit union to offer this type of loan to your members?

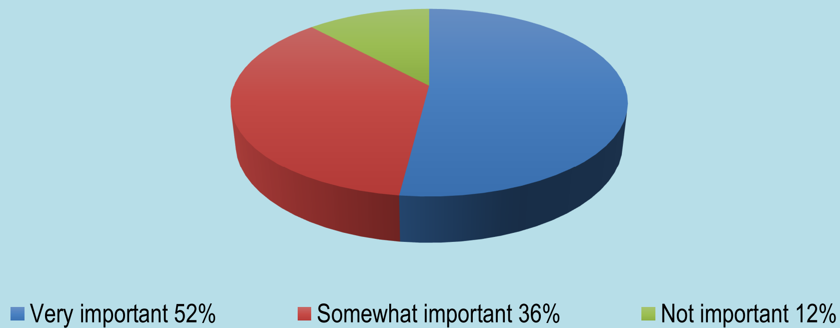
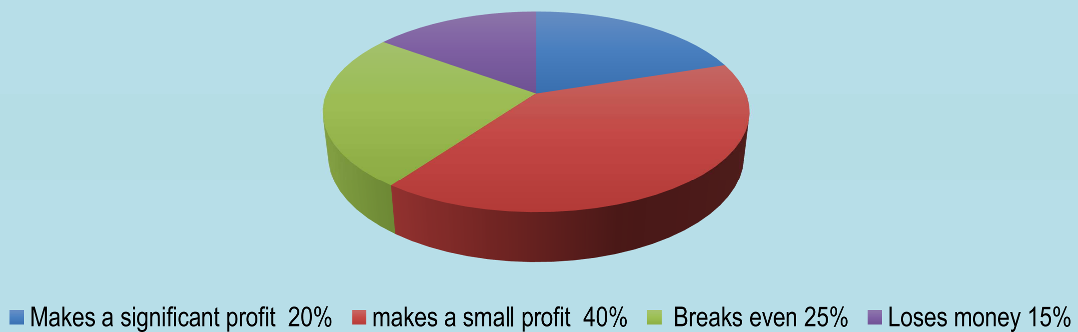


Table 6 - Which best describes the profitability of this loan for your credit union?



Legislation/Regulations

The Early Years

Payday lending regulations have changed multiple times over the last century and will most likely continue to change as the landscape of small dollar credit and consumer behavior changes. The history of regulations surrounding payday lending tells an interesting story.

More than a century ago, so called "salary lenders" offered one-week loans with APRs of 120 percent to 500 percent, similar to APRs charged by some payday lenders today. These illegal lenders used strong-arm tactics, such as extortion and the threat of job loss, to induce repayment.

State policy makers tried to suppress "salary lending" while facilitating the expansion of consumer credit from licensed lenders. The original usury interest rate cap for small loans of 6% per year was changed by the first Uniform Small Loan Law in 1916. It allowed up to 3.5% monthly interest on loans up to $300 or less. Two-thirds of the states adopted some variation of this law, which resulted in authorized interest rates from 18 to 42 percent. Consumer demand grew for small-dollar credit resulting in a greater market for installment lenders and personal finance companies.

The Financial Industry Movement

As the market changed, so did the need for regulations to change. By the middle of the 20th century, the consumer financial industry was emerging. Mortgages and credit cards were among the wide range of credit products available to consumers. In the 1970s and 1980s, a series of federal banking laws eased regulations on mortgage lenders, credit card lenders and other financial companies which basically allowed them to disregard state usury laws. Some states responded by authorizing loans made against post-dated checks and triple digit APRs. These changes set the stage for state licensed payday lending stores to thrive.

From the early 1990s through the first part of the 21st Century, the payday lending industry grew rapidly. Payday lending was shaped by a variety set of state laws and regulatory strategies. These strategies included price caps, size caps, prohibitions on repeat borrowing, prohibitions on simultaneous borrowing, "cooling-off" periods, mandates to provide amortizing alternatives, and many combinations thereof. Although some of these strategies have had acceptable outcomes, many did not resulting in several states banning payday lending.

The 21st Century

Federal law concerning payday lending has become more prevalent in recent years. In 2006, Congress passed the Military Lending Act (MLA) to help protect active duty service members and their dependents from predatory lending. This federal law placed a 36% interest rate cap on high cost closed-end loans to military families. These loans included payday loans, vehicle title loans, and tax refund anticipation loans.

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act created the Consumer Financial Protection Bureau (CFPB). The purpose of the CFPB is to promote fairness and transparency for mortgages, credit cards, and other consumer financial products and services. Specific authority was given to the CFPB to regulate all payday lenders regardless of size.

Both the Department of Defense (DOD) and the CFPB have directed energy and focus to predatory/payday lending regulation reform over the last few years. In 2015, the DOD issued a final rule amending the MLA to expand protection to cover a wider range of credit products that previously escaped the standard scope of regulation and compromised the financial readiness of our troops. This rule applies to all forms of payday loans, installment loans, vehicle title loans, refund anticipation loans, deposit advance loans, installment loans, unsecured open-end lines of credit, and credit cards. Although the rule excludes real estate secured transactions, purchase money auto transactions, and personal property transactions, the wider range of credit products included in the amendment impacts traditional creditors like banks and credit unions.

One of the most significant impacts is the inclusion of fees paid for “add on” ancillary products in the Military Annual Percentage Rate (MAPR). The MAPR calculation includes any charge that is a “finance charge” under Regulation Z, premiums for credit insurance, fees for debt cancellation contracts and fees for “credit related ancillary products”. Although the MAPR limit is 36%, ancillary product fees can add up and quickly exceed the MAPR limit. This significant change alone, will impact the payday lending industry as it relates to the military borrower.

The new rule also shifts the burden of proof of covered borrower status to the creditor. Lenders will have to identify if the consumer is covered by MLA protections. Under the new rule, lenders have to check each credit applicant to confirm they are not a service member, spouse or the dependent of a service member through a nationwide credit reporting agency or the DOD’s own database.

MLA rule compliance went into effect October 3rd, 2016. As a result, financial institutions, including credit unions, are finding they will no longer be able to offer their current payday lending programs to these covered borrowers. Compliance with the rules for credit cards is delayed until October 3rd, 2017.

In June, 2016 The CFPB proposed a new rule aimed at ending payday debt traps by requiring lenders to take steps to make sure consumers have the ability to repay their loans. The proposed rule would also cut off repeated debt attempts that rack up fees. These strong proposed protections would cover payday loans, auto title loans, deposit advance products, and certain high-cost installment and open-end loans.

Under the proposed rule, the payday, auto-title and other short-term lenders would be required to determine that borrowers can make the payments and fees when they come due and still meet basic living expenses and major financial obligations.

The proposed “ability to repay” protections include a “full-payment” test that would require lenders to determine upfront that consumers can afford to repay their loans without renewing the loan over and over.

The full proposal is 1,341 pages and all credit unions, regardless of asset size, will fall under the CFPB rule. Some of the concerns pointed out by credit unions include new reporting mandates as well as requirements that could force them to fully underwrite a small-dollar loan.

Suzanne Yashewski, senior vice president and regulatory compliance counsel at Cornerstone Credit Union, puts it bluntly: “The proposed rule would likely drive credit unions out of the small-dollar short-term loan market as well as the auto loan refinance market.”

Credit Union strategist, Scott Butterfield, is troubled by portions of the rule. He points to the requirement to verify borrowers’ ability to repay loans, and be prevented from repeatedly issuing loans to the same consumers. “This will create a vacuum since an estimated 80% of payday borrowers take out another loan within 30 days. This could limit access to non-predatory credit union products and it could also limit the number of credit unions willing to get into this space to fill a potential void,” says the consultant to more than 100 credit unions.

The proposed rule received an unprecedented level (over 1,000,000) of comments. Commentators made the point that the CFPB has failed to conduct a serious cost-benefit analysis of covered loans and the consequences of its proposal, as required by the Dodd-Frank Act. Rather, it has *assumed* that long-term or repeated use of payday loans is harmful to consumers. In response, the House Appropriations Committee has already approved delaying the new rule’s enforcement until the CFPB provides a detailed report on the new rule’s impact, including identifying existing products that would replace sources of small-dollar loans. The Fall 2016 CFPB agenda did not give an estimated date for a final rule.

To add to the uncertainty of the future of payday lending regulation, it has been said that the Trump administration would like to dismantle Dodd-Frank and replace the single director agency with five commissioners. Whether President Trump can fire the head of the independent consumer bureau or not is the subject of an ongoing legal dispute.

Regardless of how new regulations may shape the payday lending industry, credit unions must remain vigilant in our fight to ensure they permit our industry to continue to serve the needs of our members. The one thing that hasn’t changed in the history of payday lending is the need for small-dollar loans, no matter what regulations are in place.

III. RECOMMENDATIONS/SOLUTIONS

From the beginning, credit unions have diligently worked to find alternative solutions for providing assistance to low-income and underserved consumers in the community. Some have found success with years of such products and services being offered. Others are intrigued and exploring various options of assisting their members in finding immediate short-term cash flow solutions. Through our research, we discovered our own credit unions, and credit unions all across America, offer many products, services, programs, and philosophies that work together to create a path to a better financial future for our members. Here are some examples of positive contributions credit unions are providing to help our members.

Courtesy Advance Account

TruNorth Federal Credit Union has created a share account where members are able to bring negative as long as it's brought back to a zero balance within 30 days. This account was created to resolve a flaw with our Quick Cash loan program. The issue with the Quick Cash loans was that it was taking up excessive time for our consumer loan officers to continually process loans that we were not making a profit on, even at a 15% flat interest rate. The interest income was so miniscule that it was actually costing the credit union time and money. To correct this, they created the Courtesy Advance share account. The idea was that once the account was approved, they no longer had to sign loan paperwork every time. In addition, there is a $25 fee for each withdrawal from the account which meant income for the credit union. Members like the convenience of being able to get money at the teller window versus making an appointment with a loan officer to first have their request reviewed and then sign paperwork. Limits on these accounts range from $125 to $325 depending on their credit and direct deposit amount.

Overdraft Protection

Encouraging members to have direct deposit into a checking so they can participate in overdraft protection can aid in not turning to payday lenders. Having this protection allows the item to clear the members account for a fee and usually will allow the account to go negative between $300 and $350. Depending on the financial institution, these fees vary. At TruNorth Federal Credit Union in Michigan the fee is $25 while at Ferguson Federal Credit Union in Mississippi, the fee is $27. While this fee may seem like a lot, it's much cheaper than payday lenders charge. It also avoids double fees – one from the credit union for returning the non-sufficient item and one from the business for the returned payment fee.

Credit Union Better Choice

The Pennsylvania Credit Union Association came up with the "Credit Union Better Choice" program as an alternative to members borrowing from payday lenders on October 19, 2006. What's unique about this program is that it helps borrowers in transitioning from wealth-stripping products to wealth-building products by encouraging savings. The maximum interest rate is 18% along with an application fee of $25 (or less) for a loan amount up to $575.00. The term is short, ranging from 30

to 90 days in length. There are no rollovers and borrowers cannot have additional loans until the loan is paid off in full. Credit score and past credit history is not part of the loan decision. The most unique factor about this type of loan is that 10% above the requested loan amount is deposited into the members' savings account. They cannot withdraw the deposit or close their account until the loan is paid in full. Interest is then paid on the 10% deposit so long as the member pays off the loan according to the terms.

To better understand how this loan product works, it can be broken down into an example: Member A applies for a loan in the amount of $500.00. Understanding there is a $25 application fee, he asks that it be added to his loan balance. The credit union then creates the loan and deposits $500.00 into Member A's savings account. Member A's loan balance is now $575.00 ($500 loan + $25 application fee + $50 savings deposit). Member A has decided to go 90 days so that he can make three monthly payments of $197.45, paying only $17.34 in interest during this term. Because he repaid within the agreed upon term, the credit union also rebates $2.25 in interest afterward. Member A now has his loan paid in full plus $52.25 on deposit in his savings. The chart below demonstrates the advantages of this program versus visiting a payday lender. Member A has come out considerably ahead by visiting his credit union and eventually may qualify for more traditional, mainstream credit union products and services.

Credit Union Better Choice – $500 for 90 Days	**Payday Lending – $500 for 90 Days**
18% APR $25 Application Fee	Fees and interest equal to $15 per $10 borrowed every 14 days
Total cost after rebate: $40.09	Total cost for 90 days: $450
Amount in Savings Account: $52.25	Amount in Savings Account: $0

Lower Interest Loans (Quick Cash)

Many credit unions are currently offering short term, lower interest unsecured loans to those whose credit is less than stellar. The rate is higher than that of a normal unsecured loan, but still lower than that of a payday lender. TruNorth Federal Credit Union offers a product called "Quick Cash Loan" to help their members break out of the payday lending trap. To be eligible, the member must be in good standing with all TruNorth loans showing current. They must also have direct deposit and can only have one loan out at a time. General terms include a maximum loan amount of $750 for up to 60 days. However, a manager is able to approve up to $1,500 for 6 months under reasonable circumstances (new furnace, auto repairs, legal troubles, etc.). There is no application or processing fee, just a fixed rate of 15%. Peach State Federal Credit Union in Georgia offers this product as well, but their interest rate is 18% and they also charge a non-refundable fee of $20.00. They allow their members to borrow $500 to $1,000 for a term of up to six months. Our survey we conducted through CUNA also determined that there are similar products that other credit unions are offering as well as alternatives.

Auto Bailout Program

Detroit Credit Union received a grant from the Community Development Financial Institution Fund to offer an auto bailout program. This bailout program allowed them to cut the interest rate on an auto loan in half (or more) or extend the credit union's rate, whichever was lowest. For example, if a member had a $20,000 auto loan at 24% annual percentage rate (APR) with a monthly payment of $575.36 for 60 months, they'd be paying out $14,521.56 in interest. With this program, if their rate was cut in half to 12% APR with the same term, their payment would go down to $444.89 and they would save $7,828.22 in interest. Many people who are locked in at extremely high rates don't realize that such programs exist or that they could potentially refinance through other lenders at lower rates.

Loan Protection

Offering loan protection such as life insurance, disability insurance, Guaranteed Asset Protection (GAP), and extended warranties can help avoid unexpected costs resulting in borrowing from payday lenders. While these products are not free, they can be added into a loan so the protection is there should they need it. Often times credit unions are able to extend the loan term to make these products affordable as well. GAP and an extended warranty would help cover costs due to a totaled or broken auto. Life would pay off a loan if the covered borrower passed away; creating an asset for the family they left behind. Disability would ensure payments continue to be made and credit is maintained if the borrower is sick or injured and unable to work. All these items would eliminate the need for additional funds when the unexpected happens.

Risk-Based Lending

This type of lending allows credit unions to offer loans that they may not typically offer to those with lower credit scores by assessing a higher rate based on their credit score. Though the score is higher than the base rate for members in good standing, credit unions are typically able to offer a much more competitive rate than payday lenders or car dealerships. At TruNorth Credit Union, they realize that while some members pose a greater risk of default, they still need to find a way to meet their lending needs. They created a risk-based lending policy to meet these needs while also protecting the possible loan delinquency from sky rocketing as a result. Loan decisions are based on collateral, capacity, credit (more so with them versus other creditors), compensation (regular direct deposits to their account), and character. Other considerations are down payments and co-signers for members with limited credit experience or credit problems. They designed a tiered risk-based pricing policy using the FICO Risk Score Classic 04 to assign the rates. (See table below)

Credit Reporting Agency TransUnion (FICO 04)	Credit Union Alpha Code	Risk Tier	Rate Structure
776<	A+	1	Base Rate – discounted 1%
700-775	A	2	Base Rate – discounted .50%
650-699	B	3	Base Rate – no discount
600-649	C	4	Base Rate – plus 2%
550-599	D	5	Base Rate – plus 4%
>550	E	6	Base Rate – plus 6%

Extended Hours & Convenient Locations

A common response when asked why people choose payday lenders versus their credit union is the convenience of their hours and locations. TruNorth Federal Credit Union offers extended hours to help compete with predatory lenders. Between all three locations, they are open seven days per week. One branch location is even inside of Walmart! In addition to being open every day, their hours boast convenience to members. Monday through Friday they are open 7:00am – 7:00pm, Saturday from 9:00am – 4:00pm, and Sunday from 10:00am – 2:00pm. Loan officers are available until 6pm on weeknights and are available most Saturdays as well.

Increase Marketing of Services

Many credit union members are not aware of the solutions offered to help them avoid the pitfall of payday lenders. There are many ways credit unions make their members aware of these products and services. One way is advertising through their website, online banking, Facebook, Twitter, Instagram, TV and radio commercials, newspaper ads and school involvement. Another way could be through conversations with their members. By engaging in a conversation with members, credit unions can learn about their story offering solutions to help them break the cycle of using payday lenders and gain financial literacy to help them begin a journey to financial freedom.

Financial Counseling

Many people want to become money savvy, but aren't sure where to start or who to talk to. Many credit unions now have financial counselors on staff that are available at no cost to their members. Their job is to create budgets, help reduce debt, balance checkbooks, teach the value of good credit, and to examine members' current credit situations to find possible solutions or improvements. The Credit Union National Association (CUNA) offers formal programs to credit union employees so they can become certified; these programs offer a range of resources, and a network for credit union employees to draw upon for serving their members. The cost is considerably low, currently being offered at $240 for a self-study program.

Financial Education & Literacy

Educating our members, both youth and adult, is important in helping them avoid visiting payday lenders. Without a proper education, many do not understand the value of credit, why it's important to balance a checkbook, and how to manage money in general.

Member Seminars: Offering free member seminars, whether they are monthly or quarterly, on various financial topics gives members the opportunity to learn new information that they can apply in their life or the lives of those around them. It's a great way to show the community that credit unions care and that they have our support. Some recent seminars offered by TruNorth FCU include estate planning, veteran's affairs, and a crash course on credit.

Classroom Literature/Presentations: Many schools don't offer education on financial wellness simply because they lack the tools to do so. Credit unions are able to sponsor such literature for local schools in an effort to educate our youth. TruNorth Federal Credit Union partakes in two programs: Banzai and Making the Right Money Moves. Banzai is a computer-based financial literacy program that they have been sponsoring since 2012. Currently, 10 area schools take advantage of this program. Students us a workbook to follow along with a computer game that has them budget expenses into jars for different life scenarios (paying rent, auto repairs, etc.). Making the Right Money Moves is more traditional. Workbooks are utilized without the aid of a computer. It helps teach students how to balance a checkbook and create a household budget. In additional to the physical materials credit unions can offer schools, they are also capable of offering customized classroom presentations in all grade levels.

Teen Financial Reality Fair: The Michigan Credit Union League (MCUL) provides materials and training for hosting fun, fast-paced interactive financial education events. One of these events is the "Teen Financial Reality Fair" that has high school students simulating one month of independent adult living. They have to make difficult choices to obtain goods and services needed, all while working with an assigned budget and credit score. This fair involves the aid of community businesses to work various booths including auto insurance, car repair shops, and landlords. It teaches the importance of budgeting and saving money for the unexpected.

School Credit Union Branch: The earlier case studied revealed BayPort Credit Union's heavy involvement with student run credit unions. These school partnerships have afforded the students opportunities to be engaged in financial literacy activities while creating and managing savings accounts in preparation for their future. Ferguson Federal Credit Union also has a branch inside a local school that is student-run. After reaching out to the school board, it was decided that this branch could provide an opportunity for students to both learn and earn wages. It teaches the students about what credit unions are about and encourages them to save. It has been well-received within the school and community as it is a unique, hands-on way for youth to take control of their money and financial future. The cost for such branches is fairly inexpensive, but the experience is priceless for students.

Each credit union's membership base is different, so recommendations may vary based on needs. The solutions presented above offer many choices for credit unions of all sizes to consider when developing a strategy to assist members with small dollar credit needs as well as overall financial fitness. (Refer to Appendix D)

IV. SUMMARY/CONCLUSIONS

"For too long, Americans have fallen victim to financial abuses at the hands of predatory lenders that operate in the shadows" ~ Kay Hagan

The philosophy of credit unions is "people helping people." Our research helped us conclude that credit unions do in fact have a positive impact on the payday lending industry. In some cases it may be a specific loan alternative to a payday loan, while other resolutions may be as simple as basic financial education on budgeting. Countless credit unions have already implemented alternative loans, financial literacy programs, and financial counseling, and many are following in their footsteps.

The history of the industry shows that regulations have not resolved the issues surrounding payday lending. Pending and future regulations could drive credit unions to eliminate their payday lending programs altogether because of increased costs and resources devoted to compliance. Layers of regulations are not the answer. The impact of more regulation could completely wipe out the payday lending industry as we know it.

In order to have the biggest impact, credit unions need to continuously look at creative solutions for our members. We must challenge ourselves to look beyond the current situation and base our solutions on combatting the root cause that creates the overwhelming need for payday loans.

We believe credit unions can significantly decrease the need for payday loans by increasing efforts to influence current and future generations through financial literacy initiatives. Financial literacy is critical to combatting the root cause that creates this overwhelming need for payday loans. By partnering with schools and getting into our communities to provide education, we can help people take control of their financial future. It is more than balancing a checkbook or paying bills. It is about long-term vision and planning the future, and discipline to use those skills and knowledge.

It is the group's unanimous conclusion credit unions can indeed help combat the payday lending industry successfully. We have the tools, the knowledge, and the drive to ensure our members have the cost-effective alternative solutions. By building member relationships early, we can help teach good financial decision-making. It is imperative, that we are constantly striving to improve our products and services in our effort to combat payday lending. Eventually, if credit unions do this right, the need for payday lenders will be a moot point.

Individual Conclusions

Lisa C.

Going in to this paper, I was convinced that credit unions were not helping combat payday lenders. My credit union has been offering an alternative to this problem for years. When we initially introduced our new product, I thought it was a great idea, but as time passed, I quickly realized that we were doing these alternative loans for the same people over and over. No one seemed to be breaking the cycle, rather they were using this as a supplemental income that they were becoming dependent on each month. It began to weigh heavily on me, as I felt it was a disservice to our members and went against my core credit union beliefs of "people helping people." This product that was supposed to help free them from the clutches of predatory lenders was instead becoming a crutch.

After researching our topic, I began to understand that we are indeed helping our members. Even if the same people are borrowing, they are coming out better than they would if they visited a payday lending storefront for a loan. Bottom line: If we will not help our members, they will get the funds from someone else. And, if they are left to borrow from a payday lender, their fees and interest will be much higher than that of a credit union, and their terms are often shorter making the ability to repay more difficult, if not impossible. If they are already struggling to make ends meet, continuing to visit a payday lender will hurt them drastically. Even with education and better money management, if a person's income is considered poverty, there is a high probability they will need to borrow funds at some point for unexpected costs. I would rather they visit their local credit union and save in fees than go to a payday lender and come out further behind. By credit unions offering alternative products, it will save our members substantially in fees and interest.

Lisa S.

When we started exploring the topic of payday loans and if credit unions are helping combat payday loans or contributing to the problem, I did not realize how many Americans use payday loans on a regular basis for everyday expenses. I have always thought people using payday loans did so because of an emergency or were "unbanked" not having a relationship with a financial institution. Through our research I realized people using payday loans are average people just trying to make ends meet.

Being part of the credit union industry where the philosophy is people helping people, I think it is very important for credit unions to offer or find solutions for their members using payday loans. While some may believe that credit unions offering alternatives are not actually helping their members break the cycle but contributing to the problem, I feel that the credit union alternative is a better solution for the member. The interest rate charged by a credit union including any fee for the alternative loan is usually lower than the member would pay for a payday loan. Most credit unions require the member to completely pay the alternative loan before they can apply for another loan. This way the member does not have to roll over the balance and pay extra fees to extend the loan. There is usually a limit on how many of these loans a member can have during a rolling year period. These loans usually report to the member's credit report file helping them improve their credit scores and hopefully get out of the cycle of having to use payday loans or payday loan alternatives from their credit union.

My credit union, Peach State Federal Credit Union, offers an alternative to payday loans called Quick Cash. The interest rate is 18% and there is a non-refundable fee of $20. The amount a member can borrow is $500 or $1000 and the term is for six months. While we do see most of the members that use this product do so over and over, it is still a better alternative for them than using a payday loan. Peach State Federal Credit Union has built in safeguards within our consumer loan policies to protect members from high interest loans and unreasonable payment structures. We consider our loan program an affordable solution to the current high interest payday loans that are found in the market place. These high interest payday loans can ultimately cause financial ruin for our members. As a credit union our mission is to serve the undeserved. These short term loans are a needed loan source for the underserved. Many credit union members live paycheck to paycheck and often encounter circumstances that require the need for a short term loan. Through our payday loan alternative, we can meet this need at a much lower interest rate than other options available to our members.

So I feel credit unions are helping combat the problem by giving members the option of a payday alternative product or using one of the loans in their loan portfolio if they do not offer an alternative product to help their members break the cycle of using payday loans.

Jennifer

Coming into this project I knew payday lending was under scrutiny by legislators, but I was completely unaware how much the industry had grown and how many Americans have fallen victim to the underhanded operating practices of some payday lenders. My experience with payday loans was limited to a personal situation where I took out a payday loan at my credit union following my divorce. Although the participation fee seemed steep, the loan filled an immediate need and served its purpose. At the time, I had no idea how fortunate I was that my credit union offered a safe and low-cost alternative to the predatory lenders in the financial market.

The knowledge I gained from our collective research, really opened my eyes to the enormity of the problems surrounding payday lending. It also solidified my thoughts that credits unions truly do go above and beyond to help those members who come to them with payday lending needs. We don't just fill this need for our members; we look for ways to improve our member's overall financial well-being.

The biggest takeaway I received happened one evening while I was working late writing this paper. The custodian came in my office to empty my trash, so I took the opportunity and asked if she had ever needed a payday loan. She proceeded to tell me how she, a single mom, working two jobs, raising two boys had been taken advantage of by a title loan predatory lender. We talked for almost an hour and her story broke my heart. I was surprised to learn she had no idea BayPort offered payday loans. I gave her all the details and she was so excited to know if she ever needed another payday loan, she had a much better choice. That experience taught me the most. Have those conversations with people. Take the time to really get to know your members.

The credit union industry philosophy of "people helping people" was built around offering small-dollar credit. This IS our space and we should continue to work collectively as an industry to financially educate our members and provide matchless products and services to enhance the quality of life for our members.

Becky
When we began discussing what our topic should be on, I was excited when we agreed to do it on payday predatory lending and how we as credit unions are helping resolve this issue or if we were contributing to this problem. Being from rural Mississippi and living here the majority of my life, I knew there were those who borrowed from payday lenders, check cashing companies, as well as obtained loans from finance companies who charged astronomical rates of interest and high fees. What I wasn't really aware of is that it's not just an issue in rural areas. It's also a serious problem nationwide for consumers of all walks of life. Not all of these consumers were unbanked, or had challenged credit, but most all were uneducated financially.

I have had the pleasure of working for my credit union for the past 34 years and have seen firsthand how we truly go above and beyond to help others. During my years at Ferguson Federal I have seen individuals ranging in little to no financial education all the way to those that are very knowledgeable in financing. My credit union prides itself in the products and service we provide to our members and it's our goal to have more financial counselors trained to provide additional, much-needed services to our area. As our credit union has expanded our field of membership to include 12 counties in southwest Mississippi, it is exciting to know that we will have the opportunity to positively touch the lives of others, one member at a time by improving their financial well-being.

From the inception of credit unions we have maintained the philosophy of "people helping people". It's my belief that the credit union industry as a whole is helping combat payday lending. Do I believe we can do more within the industry? Most definitely! Credit union employees are very compassionate about the philosophy of people helping people. By offering A variety of product and services to consumers, I feel that credit unions are helping to combat payday/predatory lenders.

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Appendix A: Credit Union Alternatives to Payday Lending Survey

2017 Survey on Credit Union Alternatives to Payday Lending

1. Does your credit union currently offer some type of loan product that serves as an alternative to payday loans for your members? (These are loans that are short-term and small-dollar-amounts.)

 Yes No, but plan to in the next two years No, do not expect to offer this type of loan in the near future

If your credit union does NOT currently offer such loans, please skip to Q.xx9

If your credit union DOES offer a loan that serves this purpose, please continue with Q.2.

2. How long has your credit union offered this type of loan?

 Less than 1 year 1-2 years 3-5 years 6-9 years 10 years or more

3. Please tell us more about these loans.

What is the minimum term of the loan? __________ days
What is the maximum term of the loan? __________ days

What is the minimum amount that can be borrowed? __________
What is the maximum amount that can be borrowed? __________

What is the minimum interest rate (APR)? __________
What is the maximum interest rate (APR)? __________

How many of these loans can an individual member obtain during a calendar year? __________

4. In your experience, do the same members tend to apply for these loans over and over again (as often as allowed to do so)?

 The majority (more than 75%) of these loans are obtained by the same members over and over again
 More than half (55%-75%) of these loans are obtained by the same members over and over again
 About half (45%-55%) of these loans are obtained by the same members over and over again
 Less than half (25%-45%) of these loans are obtained by the same members over and over again
 Very few (less than 25%) of these loans are obtained by the same members more than once

5. What types of programs does your credit union provide to help your members out of this debt cycle, if any?
(Check all that apply.)

 Financial counseling
 Wait periods between loans
 Graduate members to small lines of credit

 Other (please describe):

____

 Credit union does not provide this type of guidance to members

6. Please indicate how important it is for your credit union to offer this type of loan to your members.

 Very important Somewhat important Not important

7. Which of the following best describes the profitability of this type of loan for your credit union?

 Our credit union makes a significant profit on these loans
 Our credit union makes a small profit on these loans
 Our credit union breaks even on these loans
 Our credit union loses money on these loans

8. Please tell us anything else you would like us to know about your credit union's payday lending alternative.

____

____

9. What is your credit union's asset size?

 Less than $50 million
 $50 million to $100 million
 $100 million to $250 million
 $250 million to $500 million
 $500 million to $1 billion
 $1 billion or more

THANK YOU!

Survey assistance provided by:

Connie Dey-Marcos, Manager of Market Research
Market Research & Consumer Engagement
Credit Union National Association, Inc.
cuna.org/Research-And-Strategy/Market-Research

Methodology

Survey conducted: January 2017 – February 2017
Methodology: E-mail
Sample Size: 154
Responses: 56
Response Rate: 36%

Appendix B: Credit Union Alternatives to Payday Lending Survey Results

Q. 1: Does your credit union currently offer some type of loan product that serves as an alternative to payday loans for your members? (These are loans that are short-term and small-dollar-amounts.)

- 35.71%- currently offer an alternative product
- 14.29% -do not currently offer an alternative product but plan to in the near future
- 50% -do not currently offer an alternative product and do not plan this type of product in the near future.

Q. 2: How long has your credit union offered this type of loan?

- 15% -less than one year
- 5% -one to two years
- 40% -three to five years
- 35%- six to nine years
- 5% -ten years or more

Q. 3: What are the dollar amounts and terms of these loans?

- Minimum term 30 days
- Maximum term 180 days
- Minimum amount of the loan $50
- Maximum amount of loan $1000
- Minimum interest rate 7.99%
- Maximum interest rate 28%
- Minimum number of loan allowed per year is one
- Maximum number of loans allowed per year is twelve

Q. 4: Do the same members tend to apply for these loans over and over again?

- 68.42% -the majority (more than 75%) of these loans are obtained by the same members over and over again
- 15.79% -more than half (55%-75%) of these loans are obtained by the same members
- 10.53% - about half (45%-55%) of these loans are obtained by the same members
- 5.26% - less than half (25%-45%) of these loans are obtained by the same members
- 0% - very few (less than 25%) of these loans are obtained by the same members

Q. 5: What type of programs does your credit union provide to help your members out of this debt cycle, if any?

- 87.50% - offer financial counseling
- 33.33% - require wait periods between loans
- 25% - graduate members to a small line of credit
- 4.17% - other
- 4.17% - do not currently provide any time of guidance to members

Q. 6: Please indicate how important it is for your credit union to offer this type of loan to your member.

- 52% - very important
- 36% - somewhat important
- 12% - not important

Q. 7: Which of the following best describes the profitability of this type of loan for your credit union?

- 20% - our credit union makes a significant profit on these loans
- 40% - our credit union makes a small profit on these loans

- 25% - our credit union breaks even on these loans
- 15% - our credit union loses money on these loans

Q. 8: Please share anything else you would like us to know about your credit union's payday loan alternative.

Most credit unions responding to the survey stated they are aware there are members in their field of membership that fall into the trap of payday loans. The main reason being they need the funds quickly to pay large past due utility bills, repair a broken furnace, auto repairs, and rent. While the majority of credit unions do offer an alternative loan product for payday loans, others try to use their unsecured loan product along with counseling to help their members break the cycle of payday loans. Several credit unions stated they serve a low income population and have a low income designation therefore; they are committed to finding ways to help members get out of the payday lending cycle before it is too late.

Q. 9: What is your credit union asset size?

- 14.29% - less than $50 million
- 10.71% - $50 million to $100 million
- 39.29% - $100 million to $250 million
- 12.50% - $250 million to $500 million
- 8.93% - $500 million to $1 billion
- 14.29% - $1 billion or more

The credit unions reporting they offer an alternative loan product for the payday loan state while the charge-off rate for this product is higher than that of their regular loan portfolio, the product still offers income for their credit union. The average income reported is approximately $200,000 over the last several years.

Among credit unions that offer at least one alternative loan product for payday loans:

- the average interest rate is 23%
- the average number of loans is 174
- the average dollar amount of alternative loans in their portfolio is $74,679
- the average dollar amount of net charge-offs is $3708.30; percentage is 1.26%
- the average dollar amount of delinquencies is $2942.06; percentage is 3.47%

Appendix C: Payday Loan Usage by Demographic and Geography

Payday Loan Usage by Demographic

According to a study conducted by Pew Charitable Trust certain demographic groups are more likely than others to have used a payday loan in the past five years. Overall 5.5% of all Americans have used a payday loan.

Age – Borrowers ages 25-29 have used payday loans at a higher rate than the general population. By contrast, loan use is below average among ages 18 to 24 and those 50 years old or older. There is relatively little usage by senior citizens ages 70 and older.

Renters vs. Homeowners – Renters have used payday loans at more than double the rate of homeowners. The difference in usage between renters and homeowners is consistent over all age categories. While payday loan usage is largely concentrated among ages 25 to 49, among 50 to 69-year-old renters, one in ten has used a payday loan this is more than triple the rate for 50 to 69-year-old homeowners. Research has also shown that renters' usage of payday loans is far higher than that of homeowners across the income levels as well. For example, 8% of renters earning $40,000 to $100,000 have used payday loans, compared with 6% of homeowners earning $15,000 to $40,000.

Income – Households with incomes of less than $40,000 are almost three times more likely to have used payday loans than those households with incomes of $50,000 or more. While most every income group has used payday loans, the income earnings with the most usage of payday loans are incomes between $15,000 and $25,000 and those with the lowest usage are those earning $100,000 or more. With the exception of those earning under $15,000, the relationship between income and payday loan usage is a reverse one, with borrowing decreasing as income increases.

Education – Borrowers without a four-year college degree are much more likely to use payday loans than those with a degree. However, among those without a four-year degree, further differences in education level do not correspond with significant differences in payday loan usage.

Race and Ethnicity – African Americans are more than twice as likely as others to have used a payday loan even though they make up less than a quarter of all payday borrowers, as compared with whites who make up 55% of all borrowers.

Parental Status – Parents are more likely to have used payday loans than those who do not have children living in their household, especially those earning less than $50,000. Research shows 12% of parents earning less than $50,000 have used a payday loan, compared to 4% of parents earning $50,000 or more.

Employment Status – Those that are currently disabled or unemployed have used payday loans at the highest rate over the past several years, although it is possible that they were employed at the time they borrowed. Those who are employed make up the majority of all payday borrowers, as having proof of income is a requirement for obtaining a payday loan.

Marital Status – Those that are separated or divorced are most likely to have had a payday loan. The percentage of separated or divorced payday borrowers is almost twice that of all other borrowers.

Payday Loan Usage by Geography

Certain geographic areas reveal higher payday loan usage than others. Oklahoma and Missouri are the leading states for payday loans. A major factor in the variation of payday loan usage in certain regions is the difference in how states regulate payday loans. There are three examples of state law types for payday loans:

Permissive – permitting single-repayment payday loans with finance charges and interest not to exceed 75% of the borrowed principal. There are twenty-eight states in this category. Some states in this category are: Missouri, Oklahoma, South Carolina, Alabama, Texas, Michigan, Wisconsin, California and Utah.

Hybrid – permits single-repayment payday loans with fees of 10% of the borrowed principal, along with a $5 fee for borrower verification with a state database of payday users. Payday loans are available up to $500 and each borrower can only have one payday loan at a time. Some states in this category are: Maine, Virginia, Florida, Washington and Colorado.

Restrictive – These states do not permit payday lending or have price caps low enough to eliminate payday lending in the state. This rate cap is often 36% APR and generally payday loan storefronts are not found in these states. This category includes states where deferred presentment transactions are not authorized (post-dated checks). Some states in this category: Georgia, West Virginia, North Carolina, New York, Maryland, Montana and the District of Columbia.

Usage by Region – Payday loan usage is the highest in the South and Midwest Region. The West and Northeast Region of the United States have the fewest percentage of payday loan usage. Urban areas have higher usage than the suburbs.

Appendix D: Additional Information on Recommendations and Solutions

Adult Financial Literacy
Financial literacy programs can help consumers avoid payday lenders by increasing consumers' financial knowledge. As previously stated the philosophy behind credit unions is "people helping people". By providing education at local levels within our communities we have the opportunity to share financial information with others to make them less susceptible to predatory lenders and improve the operations of the credit union and the credit markets. Delivering appropriate financial training to vulnerable borrowers will help them ward off predatory lenders.

Youth Financial Literacy
Teaching personal finance in schools can positively impact the financial knowledge, behavior, and self-efficacy levels of our youth and should be mandated into school curriculum. Knowing and understanding the cost of credit, what credit means, how to obtain credit, and how to rate shop will drastically reduce their susceptibility to falling into a payday loan trap. It also aids to a behavioral change as they will become more aware of their spending habits and setting and achieving money management goals.
Credit Unions can play a major role by opening an in-school branch where students run the branch under the supervision of a Credit Union employee. This provides the students with money handling skills and gives them first hand insight of the products and services offered, as well as learning valuable life skills. Whether we want to face it or not, all parents do not teach their teen's basic habits of household saving or the parents do not have good financial habits. Financial literacy training would be especially effective for these teens.

Homebuyer Training
By providing classroom or one on one counseling, consumers can be taught to rate shop and not feel like they cannot obtain a mortgage or that they have to settle for less of a house due to high interest rates and terms. Homebuyer training can also help reduce delinquency rates and can provide valuable information concerning the financial aspects of not only buying a home but how to maintain and keep it. Buyers must be prepared for the ongoing financial burden of homeownership, including property taxes, homeowners insurance, utilities, and general upkeep and maintenance costs.

Talk to Creditors
Talking to creditors about extending due dates or deferring payments is also something consumers should try when financially burdened. When individuals know they will not be able to make a payment, it's critical to stress the importance of letting their creditors know. Often times creditors will allow a due date extension without reporting to the credit bureaus. Ignoring a problem will not help correct it. It is often perceived as a lack of caring on the delinquent borrower's part by a creditor. Whether or not that is the case, that is the perception the creditor has since they haven't been told otherwise by the borrower.

Work Overtime
If employers allow it, working a few extra hours to get additional or overtime pay can help significantly when trying to catch up on debts. For salaried workers, this is not always an option, but for hourly, this is a great way to increase their take-home pay.

Payroll Cash Advance

Some employers offer advances on paychecks. By taking the time to discuss options with their human resources department, if any, they can potentially obtain a payroll advance that doesn't include fees or excessive rates.

Overdraft Protection
Instead of bouncing checks, it's important to see if borrowers' primary financial institution offers overdraft protection. This is an alternative to returning a check when fundS are unavailable. Instead, the check clears with a smaller fee than what most would pay at a payday lending storefront.

Utility Assistance
Many utility companies offer affordable payment plans or budget plans to those who have trouble staying current. Whether renting or buying, monthly utility bills must be paid in order to keep heat, power, and water/sewer. Having these payments on a budget plan can help with budgeting significantly.   Instead of having $30 heating bills in the summer and $200 bills in the winter, a budget plan has you paying an average so you know what to expect each month.