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FACT SHEET

Payday lending reform: Ending a debt trap in Alabama

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On busy highways and run-down streets across the state, you can't miss them: big, bright signs promising easy money. From payday loans to auto title pawns to anticipation loans on tax refunds, Alabamians face a dizzying array of credit services designed to trap consumers in financial quicksand. This fact sheet highlights the pitfalls of payday loans in Alabama and offers policy solutions to address them.

Legalized usury?

Payday loans allow borrowers with a bank account to use a check dated in the future (usually two weeks later) as collateral for a cash loan. To qualify, all a person needs is proof of income (a pay stub or verification of government benefits). Research shows the payday lending business model is designed to keep borrowers in debt. Borrowers who receive five or more loans a year account for the large majority of payday lenders' business, according to research by the Center for Responsible Lending (CRL).

Most states have laws against usury, or excessive interest, but in some states like Alabama, lawmakers have carved out special exceptions for certain types of loans, including payday loans. The catch, however, is the huge profit that high interest rates pull from the pockets of vulnerable borrowers. Predatory lending promotes poverty by exploiting those caught in the gap between low wages and the real cost of getting by.

Each $100 borrowed through a payday loan in Alabama carries a "loan origination fee" of up to $17.50, and those charges occur with every renewal of the loan. With a 14-day loan period, this works out to an annual percentage rate (APR) of 456 percent. Loans that a customer cannot pay off entirely on the due date are rolled over, with no wait required for the first rollover and only a 24-hour wait required before the second. At triple-digit annual interest rates, even a short-term payoff for a payday loan can take a big bite out of a borrower's bank account.

Using payday loans doubles the risk that a borrower will end up in bankruptcy within two years, according to the Consumer Federation of America. It also doubles the risk of being seriously delinquent on credit cards and makes it less likely that consumers can pay other household bills. Payday loan use also increases the likelihood that a consumer's bank account will be closed involuntarily, which may subject the borrower to criminal prosecution under worthless check laws.

Alabama's payday loan database reveals the depth and details of the debt trap. A meager 22 percent of all payday loans go to borrowers who have more than 12 loans a year. Yet these borrowers are trapped into paying $56 million in fees, nearly half of all fees collected on payday loans in Alabama each year.

Serial borrowers are the bread and butter of payday lending, CRL research shows. Among payday borrowers who conduct multiple transactions, half take out new loans at the first possible opportunity, a process called "churning." This cycle of deep debt is big business. After six loans, borrowers typically have paid more in fees than the amount of the initial loan.

Struggling Alabamians are common targets of payday lenders. Payday lenders are located disproportionately in low-income neighborhoods, especially ones with large black or Hispanic populations. Lenders often target seniors, people without a high school education, and families who are likely to be living from paycheck to paycheck.

Understanding opposition to payday reform

Alabama's payday loan industry rakes in more than $100 million a year in fees. Lenders have used a portion of that money to hire a fleet of lobbyists to oppose reform in Montgomery. In 2017, a proposed state constitutional amendment to cap all consumer loans at 36 percent APR failed in the House Constitution, Campaigns and Elections Committee. And in 2018, the House Financial Services Committee killed a bill that would have given Alabama borrowers 30 days to repay payday loans (up from as few as 10 days under current law), even though the Senate voted for the measure by a significant margin.

Lenders' inflexibility facilitates a status quo that benefits them financially. Many legislators assert that they will not consider a reform bill without input from both consumer advocates and lenders. This allows lenders to preserve their existing advantage simply by opposing even small, reasonable changes.

Straightforward solutions

No state has legalized payday lending since 2005. In fact, 18 states and the District of Columbia essentially have banned payday loans. In 2006, Congress outlawed predatory lending to military personnel and their dependents, capping interest rates at 36 percent APR and barring loans based on holding checks or debit authorization for future payment. And the Consumer Financial Protection Bureau's new rule requiring lenders to assess consumers' ability to repay could help prevent defaults (if the agency doesn't weaken it).

Alabama could build on this momentum for change by enacting several reforms to improve the lending landscape for the state's borrowers:

- Capping the interest rates on all consumer loans in Alabama at 36 percent would broaden the protections that now apply to military borrowers.
- Cutting the fee for originating a loan from the current $17.50 per $100 would lessen the financial burden on borrowers.
- Restricting the borrowable amount to 10 percent of the borrower's income would reduce the risk of borrowers becoming trapped because they cannot repay the entire loan amount at once.
- Allowing borrowers to pay loans off in installments would let people work themselves out of debt gradually instead of making them pay a loan off all at once.
- Giving borrowers 30 days to repay payday loans would cut the effective APR from 456 percent to about 220 percent. It also would reduce the administrative burden on lenders, borrowers and the state.

Bottom line

Payday lenders are on track to pull more than $1 billion in fees out of Alabama communities over the next decade. Nearly all of their profits will flow to out-of-state companies. Advocates of payday lending reform will have to build massive public support to fight the well-funded lenders, who often target legislative leaders and committee members to help protect the status quo.

The challenges may be great, but real payday lending reform for Alabama borrowers can and will happen. Proof came in 2015, when the state Banking Department responded to years of public pressure by creating a uniform statewide payday loan database and requiring lenders to check it for outstanding loans. That move kept thousands of Alabamians from sinking even deeper into debt by finally enabling the state to enforce its $500 limit on the amount of payday loans that an individual can have at one time.

Now it's time for Alabama to take the next big step for borrowers by cutting the APR on payday loans to a more reasonable level. This simple but important change would be a great way to keep more money in our state's economy, encourage household financial stability, and strengthen communities across Alabama.