

Restrictions on Payday Lending and Access to Credit



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Disclaimer

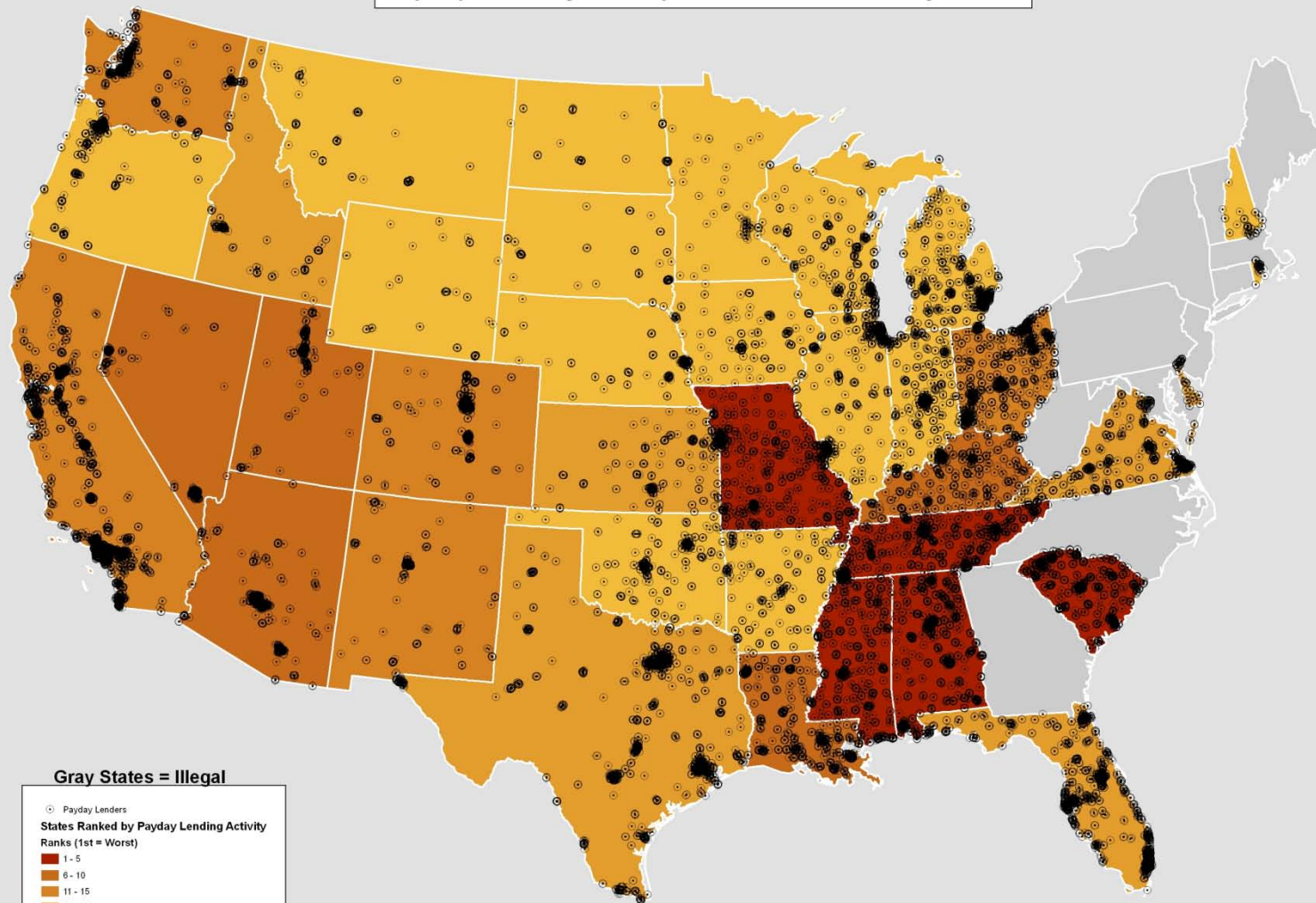
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What Is a Payday Loan?

- ▶ More accurately, a “deferred deposit loan”
- ▶ Is typically:
 - ▶ Small dollar
 - ▶ Short-term
 - ▶ Unsecured
 - ▶ Made to a high risk borrower



Payday Lending Activity: U.S. States, Rankings, 2007



○ Payday Lenders
States Ranked by Payday Lending Activity
Ranks (1st = Worst)

- 1 - 5
- 6 - 10
- 11 - 15
- 16 - 20
- 21 - 39
- Illegal

Source: State Regulatory Authorities, FDIC, Business Directories

Graves, Steven and Christopher Peterson. 2008. Usury Law and the Christian Right: Faith Based Political Power and the Geography of American Payday Loan Regulation. Catholic University Law Review 57 (3)

Could Restrictions on Payday Lending Harm Consumers?

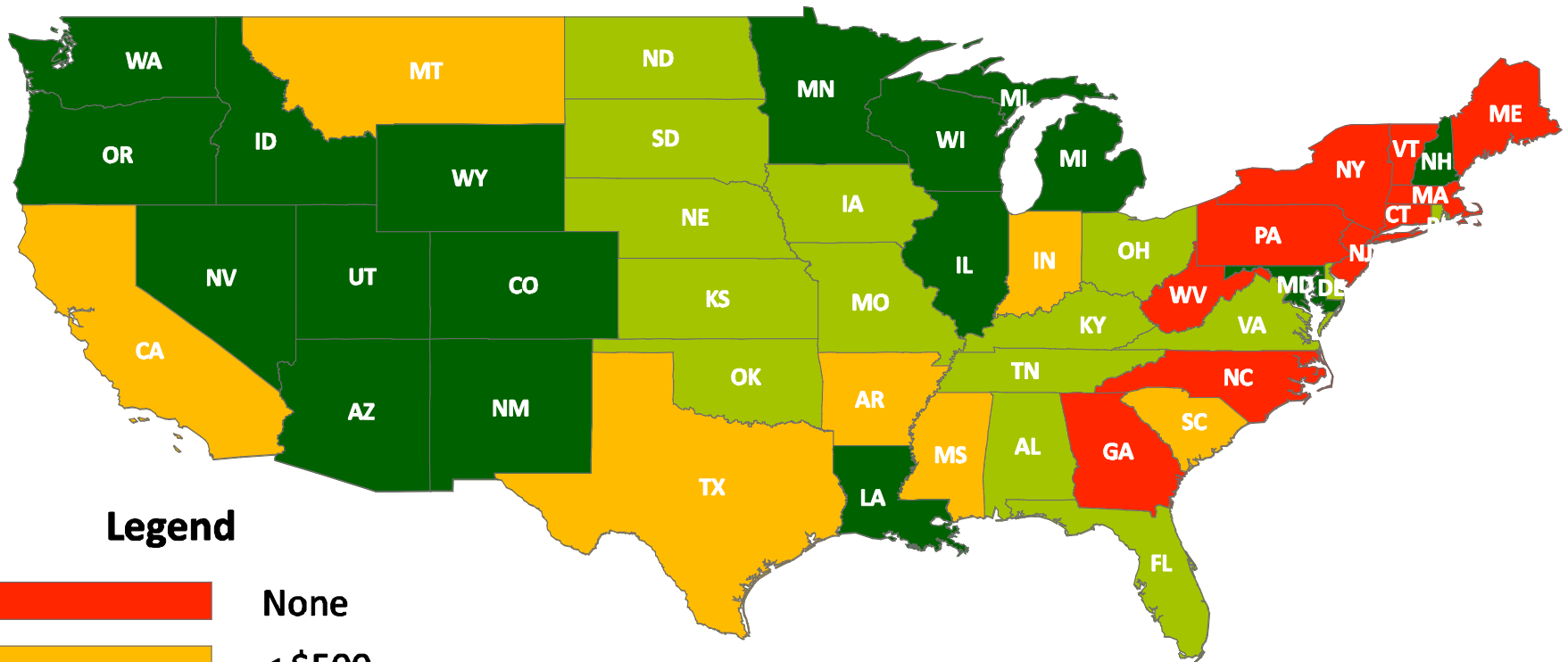
- ▶ How Might Payday Lending Harm Consumers?
- ▶ Payday Lending Restrictions
- ▶ How Might Payday Lending *Restrictions* Harm Consumers?
- ▶ New Evidence on the Effects of Payday Lending Restrictions

How Might Payday Borrowing Harm Consumers?

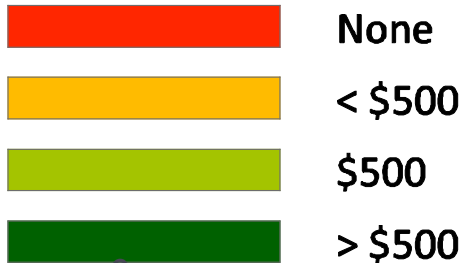
- ▶ High cost
- ▶ Debt spirals
- ▶ Targeting of at-risk populations



Maximum Loan Amounts



Legend



Other Common Restrictions

- ▶ Rollover limits
- ▶ Rights of rescission
- ▶ Limits on collateral requirements
- ▶ Payment plans for troubled borrowers

A person wearing a light blue dress shirt and a red necktie is holding several large stacks of US dollar bills. The person's hands are visible, and the stacks of money are piled high. The background is slightly blurred, showing what appears to be an office or business setting.

Potential Costs of Payday Lending Restrictions

Access to Credit

- ▶ **No credit**
 - ▶ Family and friends?
- ▶ **More costly credit**
 - ▶ Over-the-limit credit card purchase
 - ▶ Bounced checks
 - ▶ Pawn brokers
 - ▶ Loan sharks



Less Costly Payday Loan Alternatives

- ▶ Payment plans with creditors
- ▶ Employer advances
- ▶ Credit counseling
- ▶ Emergency assistance programs
- ▶ Credit union loans
- ▶ Cash advances on credit cards
- ▶ Military loans
- ▶ Small consumer loans



Other Potential Costs

- ▶ **Credit Standing**
 - ▶ Reporting to credit bureaus
 - ▶ Late bill payments
- ▶ **Convenience**



New Evidence on the Effects of Payday Lending Restrictions



New Evidence on the Effects of Payday Lending Restrictions

- ▶ **What is the effect on access to credit?**
 - ▶ Use of traditional credit
 - ▶ Number of credit accounts
 - ▶ Number of new credit accounts
 - ▶ Total consumer debt from traditional lenders
- ▶ **What is the effect on credit standing?**
 - ▶ Credit scores
 - ▶ Late bill payments

Do payday lending restrictions shift borrowers to traditional credit? **Key Results.**

- ▶ Borrowers with (legal) access to payday loans have, on average,
 - ▶ a modestly higher number of traditional credit accounts
 - ▶ a modestly higher number of new credit accounts each quarter
- ▶ But
 - ▶ typically carry a smaller load of traditional consumer debt
- ▶ Borrowers in low-income counties do not carry more traditional debt, likely reflecting difficulty in accessing traditional credit

Do payday lending restrictions shift borrowers to traditional credit? **Analysis.**

- ▶ Evidence is mixed generally, but for low-income counties, supports the notion that consumers living where payday lending is not legally accessible do not access traditional credit in the alternative
- ▶ These results suggest, but do not prove, that low-income borrowers in states with payday loan bans either lack access to short-term credit of any type or utilize alternatives that may be more costly
- ▶ Some consumers in higher-income counties may switch to traditional credit, but they do not tap additional accounts to do so

Do Restrictions on Payday Lending Harm Consumers' Credit Standing? **Key Results.**

- ▶ The share of consumers with the lowest credit scores (bottom 5 percent, 10 percent, or 25 percent) is higher, on average, in counties where payday loans are not legally accessible
- ▶ The share of consumers with late bill payments is higher, on average, in counties where payday loans are not legally accessible
- ▶ Results were similar when only low-income counties were considered

Do Restrictions on Payday Lending Harm Consumers' Credit Standing? **Analysis.**

- ▶ The evidence suggests that consumers with access to payday lending may be better able to maintain their credit standing than those without access to payday lending

Conclusions

- ▶ Restrictions on payday lending may have some unintended consequences for consumers, especially those with low incomes
 - ▶ Lack of access to credit
 - ▶ Diminished credit standing
- ▶ This analysis, in and of itself, cannot not establish whether a ban on payday lending is an appropriate policy or not
- ▶ But it does suggest that these potential adverse effects should be considered in thinking about an appropriate regulatory response to payday lending issues

Conclusions

- ▶ This study has some limitations and should be considered as a first step in understanding the impact of payday lending restrictions on access to credit and consumer credit standing
 - ▶ Data limitations
 - ▶ Internet lending
- ▶ Additional research would add significantly to the discussion
 - ▶ A similar analysis based on the concentration of payday lending establishments
 - ▶ Surveys of former payday loan borrowers in states with new restrictions



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