



FEDERAL RESERVE BANK *of* KANSAS CITY

# Restrictions on Payday Lending and Access to Credit

United Way

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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

# Restrictions on Payday Lending and Access to Credit

- How Might Payday Lending Harm Consumers?
- Payday Lending Restrictions
- How Might Payday Lending *Restrictions* Limit Access to Credit?
- New Evidence on the Effects of Payday Lending Restrictions

# How Might Payday Borrowing Harm Consumers?

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

Restrictions on Payday Lending and Access to Credit

# **PAYDAY LENDING RESTRICTIONS**





# Other Common Restrictions

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



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# **POTENTIAL COSTS OF PAYDAY LENDING RESTRICTIONS**

# Unintended Consequences: 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

Source: Center for Responsible Lending

# Other Potential Costs

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

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**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 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





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