Could Restrictions on Payday Lending Harm Consumers? A Research Seminar

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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

Could Restrictions on Payday Lending Harm Consumers?

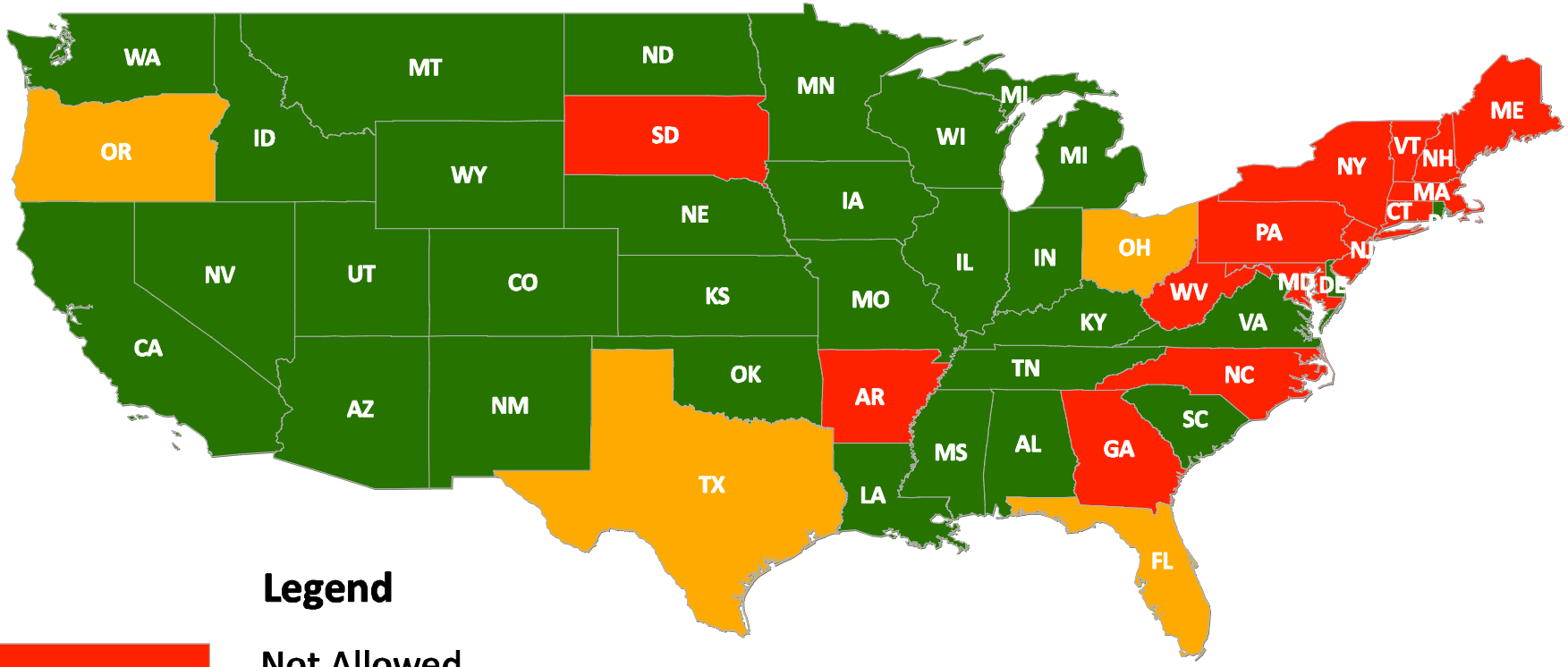
- How Might Payday Lending Harm Consumers?
- Payday Lending Restrictions
- How Might Payday Lending *Restrictions* Harm Consumers?
- New Evidence on the Effects of Payday Lending Restrictions

How Might Payday Borrowing Harm Consumers?

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

Payday Lending Restrictions

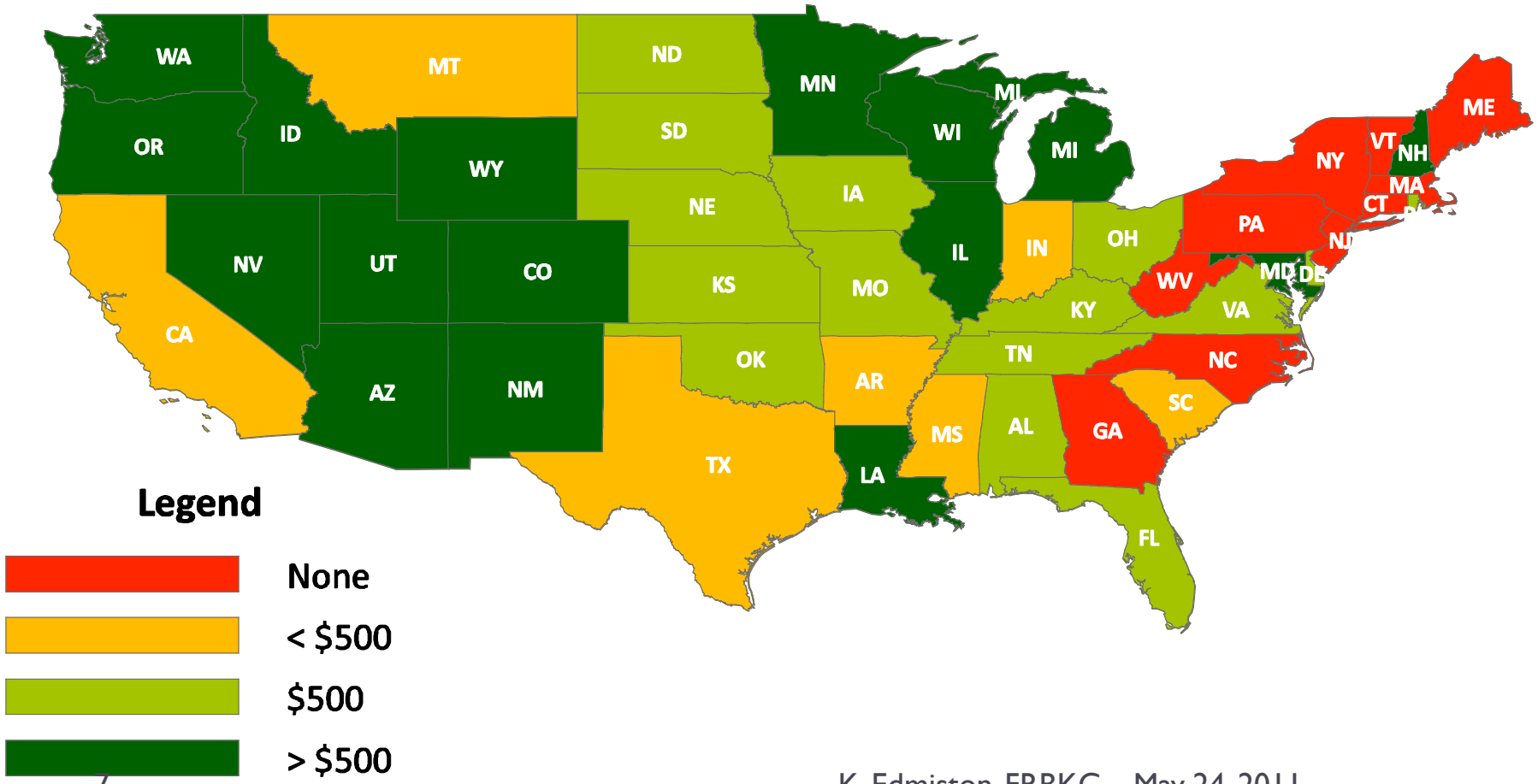
Effective Bans on Payday Lending



Legend

- Not Allowed
- Maximum Fee < $15/$100
- Allowed

Maximum Loan Amounts



Other Common Restrictions

- Rollover limits
- Rights of rescission
- Limits on collateral requirements
- Payment plans for troubled borrowers
- Limits on lending to military personnel *

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

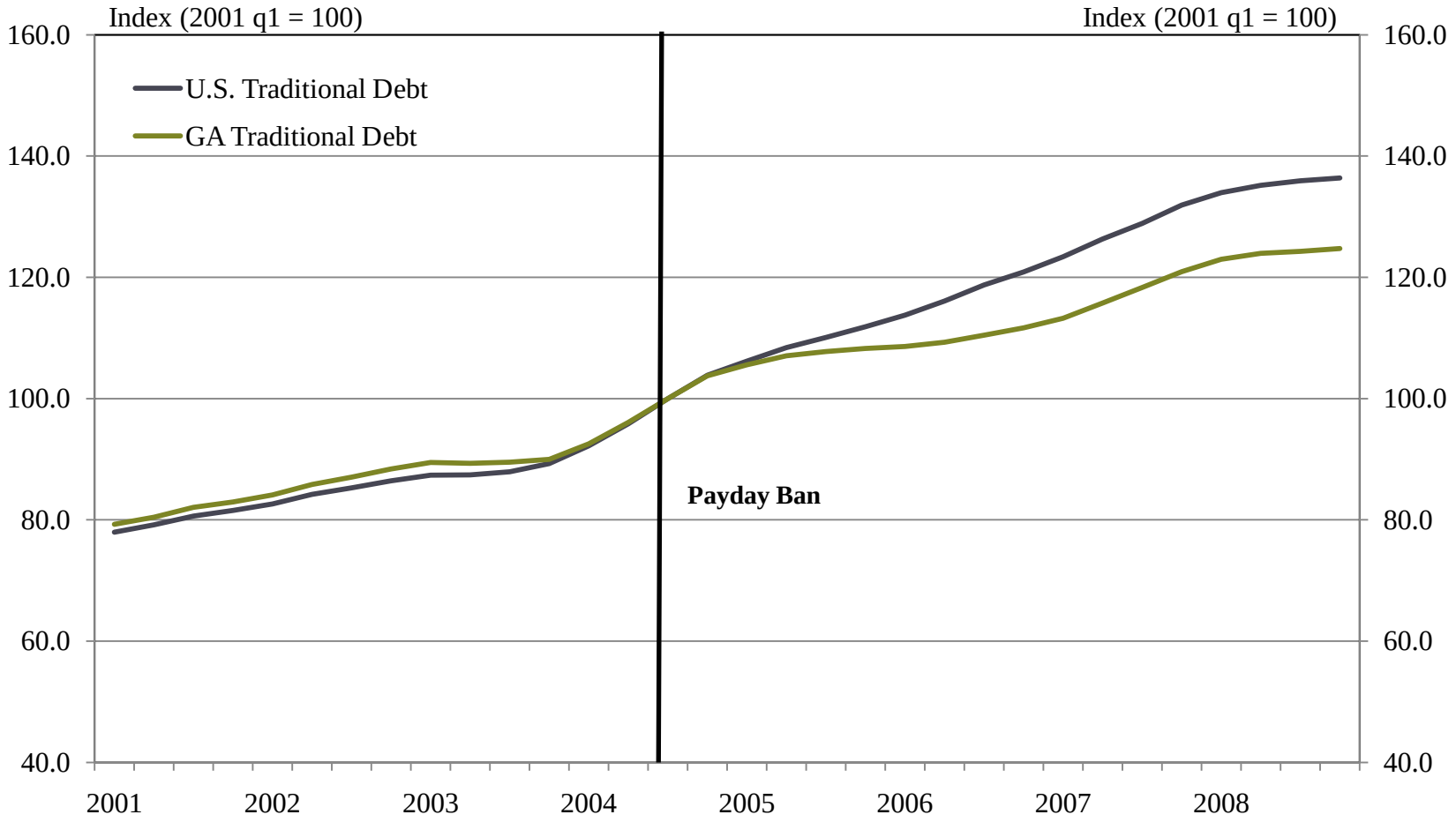
- Credit Standing
  - Reporting to credit bureaus
  - Late bill payments
- Convenience

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?



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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