Restrictions on Payday Lending and Access to Credit

United Way
North Kansas City, MO
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Federal Reserve Bank of Kansas City

The presentation reflects the views of the presenter and not necessarily those of the Federal Reserve Bank of Kansas City or the Federal Reserve System
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
Effective Bans on Payday Lending

Legend

- **Red**: Not Allowed
- **Yellow**: Maximum Fee < $15/$100
- **Green**: Allowed
Maximum Loan Amounts

Legend

<table>
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<tr>
<th>Color</th>
<th>Range</th>
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<tbody>
<tr>
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<tr>
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<tr>
<td>Dark</td>
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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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