THE MANY FORMS OF PREDATORY LENDING

Prepared for the "Credit in Today's Society" Conference
April 30, 2010
Federal Reserve Bank of Richmond

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Introduction

- Despite my title, I'm going to try to convince you that identifying "predatory" lending is not cut and dried.
- Organization of my talk
- Warning: Some of the material at the end is a bit pointy headed

An Overview of High-Cost Consumer Loans

- Pawn Loans
- Title Loans
- Payday Loans
- RALs
- Rent-to-own

- Are they predatory? They are high-cost and targeted to consumers with bad credit.
- To make this concrete, I'll present an in-depth analysis of payday loans.

Payday Lending in Maryland

- There are about 20,000 payday loans stores around the country but very few in Maryland
- Why? Maryland has a usury cap of 33 percent APR on consumer loans.
- Maryland General Assembly recently plugged a loophole that some lenders were using. They charged 33% APR but worked with a broker that added other fees, making the rate closer to 400% APR.

Payday Lending In Other States

- Payday lending is widespread in about 35 states.
- Description of a payday loan transaction
  - Typical loan size and maturity
  - Typical fees
  - Credit screening process
  - Speed
- What if a customer can't repay?
  - Renew
  - Default


PAYCHECK
ADVANCE
PAYDAY LOANS
OPEN
281-2212
WHERE EVERYDAY IS PAYDAY! WHERE EVERYDAY IS PAYDAY!
503-281-2212


$50. to
$500.
NO
CREDIT
CHECKS
PAYDAY
LOANS
Same day service

How Did the Business Evolve?

- Grew out of the check-cashing business in the early 1990s, but always had antecedents.
- Has become reasonably sophisticated with a specialized credit check firm (Teletrack) and tailor-made software.
- Several large multi-state firms and a few international publicly-traded firms (Advance America, Dollar Financial, and Cash America)
- Advantages and disadvantages of the large firms from the perspective of consumer advocates.

Who Uses Payday Loans?

- Demographics of the customer base
  - Have bank accounts and jobs
  - Make $15,000 to $50,000, with somewhat higher household incomes
  - High school graduates
  - Relatively few older adults. Many customers are young and have poor money-management skills.
  - Disproportionately African-American & Hispanic. Why? Less wealth. Less familiarity with, or trust of, mainstream credit sources.

Why Do People Borrow?

In surveys the customers say:

- Pay bills
- Meet a financial emergency
- Buy groceries
- Other

But such surveys are in some sense unsatisfactory

Why Borrow at 400% APR?

- Lack access to lower-cost alternative
- Bad credit history
- Maxed out on credit cards
- Loans are fast, no credit check, and convenient
- People don't think about the APR, but do know the finance charge, i.e., $45 for a two-week $300 loan

The "Rollover" Issue

- California Department of Corporations (2007) study:
  - 19 percent of payday loan customers took out 15 or more loans over an 18 month period. 16 percent took out only one.
  - Based on the focus groups, the study stated, "When asked if they would recommend payday loans to others, most indicated that they would provide the information about payday lending, but would also provide cautions to the 'addictive', 'repetitive', and 'vicious' cycle that can be a part of the payday lending experience."

- Colorado UCCC (2008) study found:
  - Payday loan customers borrowed on average 9.7 loans.
  - Customers with 12 or more loans accounted for 67 percent of all loans.
  - 65 percent of all loans were made on the same day that a customer repaid a previous payday loan
  - "…during 2007 the 'average' [payday loan] ...consumer paid about $573.06 in total finance charges to have borrowed $353.88 for a period of little more than five and one-half months at each [payday loan] ...location with which that consumer did business."

- In Florida:
  - Average number of loans between June 2008 and May 2009 was 8.4.
  - 32 percent of the customers took out 3 or fewer loans.
  - 30 percent had 12 or more.
  - 61 percent of the loans were to customers who took out 12 or more loans.

- Guidelines of the payday lenders' trade association
  - "Members shall not allow customers to rollover a loan (the extension of an outstanding advance by payment of only a fee) unless expressly authorized by state law, but in such cases where authorized the member will limit rollovers to four (4) or the state limit, whichever is less. "

- Problem is that repeat customers are essential for profitability

Many People Want to Ban Payday Lending

The Big Question: Should It Be Banned?

- No.
  - People understand the loans and no one forces them to take out a loan.
  - They can benefit people facing even higher cost alternatives with an emergency need for cash
- Yes
  - People are myopic and seduced by easy access to cash. The loans just lead to greater financial troubles down the line.

The Academic Approach

- Ideal approach would be to run a random assignment study. But such a study would be difficult.
- Several quasi-experimental studies based around state bans. Brief discussion of rationale for differences-in-differences approach.
- Example: Oregon study by Jonathan Zinman of Dartmouth College. "Restricting Consumer Credit Access: Household Survey Evidence on Effects around the Oregon Rate Cap," *Journal of Banking and Finance*, 2010.

Findings from Zinman Study

	Oregon Baseline	Oregon Follow-up	Washington Baseline	Washington Follow-up	Difference-in-difference
Any payday loan in last 3 months	1	0.505	1	0.789	-0.284***
Used any short-term loan in last 3 months	1	0.570	1	0.830	-0.260***
Harder to get short-term loan last 3 months	0.158	0.388	0.045	0.090	0.185***
Unemployed	0.121	0.151	0.131	0.131	0.030
"…your financial situation in the last 6 months." getting worse	0.172	0.207	0.181	0.156	0.060
"Thinking about the future, do you expected your financial situation to" get worse	0.046	0.066	0.061	0.036	0.046*
Positive response to any of the above three questions	0.279	0.345	0.313	0.262	0.177**

- Zinman concludes that these survey results "…suggest that the Oregon Cap reduced the supply of credit for payday borrowers, and that the financial condition of borrowers (as measured by employment status and subjective assessments) suffered as a result."

- Why you might doubt this conclusion.
  - Are the customers in Washington and Oregon the same?
  - Are the customers in the two states subject to the same outside forces?

Conclusions

- No academic study yet strongly supports banning or approving payday lending. We are all experts at this point.
- Answer could be complex: Payday lending benefits some people and harms others. It comes down to a judgment call.
- One public policy recommendation on which almost all agree is that it would be best if people could build savings and clean up credit histories so that they do not need to use payday lenders. *This is where you come in, and this lesson applies for avoiding all high-cost consumer creditors*.

- Thanks!

- I’m excited to hear your views.