

# **Payday Lending: A Mature Industry with Chronic Challenges**

***Research Methods***

**&**

***Summary of the Academic Literature  
on Payday Lending***

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# Outline

## A. Research Methods

## B. Payday Loan Academic Literature

1. Method

2. Industry dynamics

3. Do payday loans benefit consumers?

4. The impact of payday loan regulations on consumers

5. Discussion

# Research Methods

- Interdisciplinary
- Mixed methodology
  - Quantitative methods
  - Qualitative methods
  - Triangulation

# Method

- Reviewed the literature primarily in October through November 2015
- Searching select academic databases including Econlit, PAIS International, and Jstor
- Using the keywords “payday loan” or “payday lender”
- Focused on literature since 2010

# Method

- The payday loan industry has matured as has the literature related to it:
  - Entire monographs available, e.g.,
    - Carl Packman's 2014 *Payday Lending: Global Growth of the High-Cost Credit Market*
    - Mehrsa Baradaran's 2015 *How the Other Half Banks: Exclusion, Exploitation, and the Threat to Democracy*

# Method

- Some issues no longer particularly topical (e.g., spatial analysis)
- This does not mean that spatial issues are not an ongoing concern but that the literature does not focus on it as much as in the early days of the industry

# Method

- Key issues that surfaced from the literature:
  - Industry profitability and growth
  - Corporatization and online lending
  - Consumers' experiences with payday loans
  - The impact of regulation on payday lending

# Industry dynamics

- Financialization –a process linked with contemporary economic growth and globalization– *which is the expansion of financial motives and increase in the number and size of financial products.*
- Payday lending is a mature industry and one that faces chronic challenges associated with critics' claims that the product harms its customers through location strategies, high fees, repeat loans, and now new problems associated with internet payday loans.

# Industry dynamics

- Evidence of plateauing size in older markets, e.g., Canada
- Expanding geographic scope: UK, Eastern Europe, Australia, New Zealand, South Africa
- Corporatization
- Offer a variety of services
- Use of internet

# Industry dynamics

- The US payday lending industry:
  - One estimate finds the US industry worth USD 100 billion (Baradaran 2015); \$US40 billion annual lending
  - Outlet #s: 10,000 in 1999 to 12-14,000 in 2001 to 20,000 by 2005

# Industry dynamics

- Estimates of payday lending in Canada based on indicators,
  - Number of outlets, estimated between 1,200 and 1,500 currently
  - Value of annual lending estimated at \$Can 2.5 billion

# Do payday loans benefit consumers?

- What is the impact on consumers?
  - Caskey (2011, 2012) argues that answering that question is complicated by the mixed empirical evidence and by ideological differences.
  - Melzer (2014) summarizes the literature to date by stating “there is evidence that the expansion of payday credit aggravates financial difficulties, *at least for a subset of borrowers* (italics added) (Melzer 2014, p.3).”

# Do payday loans benefit consumers?

- What is the impact on consumers?
  - The Pew Charitable Trusts also undertook a major study since Caskey's review, including surveys and focus groups of payday clients. One key result is that payday loan clients themselves “experience complicated and conflicted feelings.”
  - This is because the borrowers have “appreciation for friendly service, dismay with the high cost, and frustration with lengthy indebtedness (Pew Charitable Trusts 2013, p.39).”

# Do payday loans benefit consumers?

- Repetitive borrowing
  - Identified as an issue in the literature from the early days of study and continues today
  - The early literature was concerned with roll-overs and their exponential fees

## Do payday loans benefit consumers?

- Repeat Loans
  - Current literature concerned with repeat borrowing, for instance:  
“reliance on payday loans for an extended period of time seems contrary to the short-term financing intention of the product and may exacerbate rather than relieve financial problems some consumers face (Lawrence and Elliehausen 2008, p.315).”

# Do payday loans benefit consumers?

- Repeat Loans
  - Baradaran argues that payday lenders do not underwrite their loans and this is an inherent weakness of the payday loan model.
  - She argues that payday lenders do not check the credit worthiness of borrowers, do not test the difference between insolvent and illiquid people so that it is not a good credit model.

# Do payday loans benefit consumers?

- Repeat Loans
  - Some borrowers who will be unable to pay-off the loan, unrealistically think they can pay-off the loan –principal and interest-- in two weeks
  - No *caveat emptor*: consumers relying on payday lenders' information that themselves rely on repeat borrowers for their businesses to prosper. Fifty-four percent of borrowers relied 'completely' on payday lenders for information about the payday loan (Pew Charitable Trusts 2012, p.19-29).
  - Some borrowers find the ease with which they can access payday loans as part of the problem as it creates a 'temptation' they cannot resist.

# Do payday loans benefit consumers?

- Repeat Loans
  - US literature finds repeat borrowing common
    - The Consumer Financial Protection Bureau found that “the median borrower in the CFPB sample took out ten payday loans from a single lender during the year, paying \$458 in fees alone for \$350 in non-churn principal (Montezemolo 2014, p.4)”
    - Data from state regulator databases find borrowers take out 9, on average US\$346, loans per year involving US\$504 in fees

# Do payday loans benefit consumers?

- Repeat Loans
  - US literature finds repeat borrowing common
    - The Pew Charitable Trusts research finds borrowers take out eight 18-day, on average US\$375, loans in on year and owe US\$520 in fees
    - A study from the Center for Financial Services Innovation found that borrowers take out 11 loans in one year and Advance America, the US's largest payday lender, reports its clients on average take out eight loans per year (Montezemolo 2013, p.4).

## Do payday loans benefit consumers?

- Repeat Loans
  - The Pew Charitable Trusts research project investigated consumer motivation behind borrowing many loans in a short period of time and point to the following factors (Pew Charitable Trusts 2012, p.19-29)
  - Consumers needing cash to meet an urgent expense. Thirty-seven percent of borrowers said they would accept a loan on “any terms offered”

# Do payday loans benefit consumers?

- Repeat Loans: Canada
  - Data are limited
    - An FCAC-sponsored survey undertaken by Ipsos-Reid it was found that 52.4% of respondents who reported taking out a payday loan at least 12 times per year had household incomes of less than \$30,000.

# Do payday loans benefit consumers?

- Repeat Loans: Canada
  - Drawing on more limited data from the 2009 Canadian Financial Capability Survey Simpson and Bazarkulova (2013) found more evidence of that repeat borrowing is more common among poor and modest income and asset-holding Canadians as compared to the non-poor.

# Do payday loans benefit consumers?

- Repeat Loans: Canada
  - Consumer Protection BC provided data that finds that the average annual number of loans per borrower in that province has moved from 5.9 in 2012 to 5.4 in 2013 to 4.3 in 2014 (Consumer Protection BC, undated). The number of individuals with more than 15 loans in one year increased by 34% to just fewer than nine thousand people.

# Do payday loans benefit consumers?

- Repeat Loans: Canada
  - Nova Scotia's regulator noted that, for Nova Scotia in 2013-14, 52% of all payday loans were repeat loans of some type and, of those, 30% received 8 or more loans: "It is estimated that these borrowers, which total about 5,000 individuals, received an average of 13 loans each in addition to initial loans (Service Nova Scotia 2015)."

# Do payday loans benefit consumers?

- Privacy issues
  - Evidence that fringe bank clients, in general, maintain more anonymity as compared with mainstream bank clients
  - But payday lenders require some personal ID, e.g., bank account information, references, and in some cases request social insurance number
  - Internet lending raises important challenges

## **Do payday loans benefit consumers?**

- Online payday lending

“Online trends younger, to people who are more comfortable with e-commerce as a safe platform. It also trends slightly higher in income. But many of our online customers are also in-store customers.” He added that online consumers are service sensitive, not price sensitive. “Ease and speed of service trumps price. That’s a general rule of all e-commerce” (Denise Barrett Consulting 2015, p.21-22).

# Do payday loans benefit consumers?

- Online payday lending
  - Asymmetry of information
  - Costs different than store-front: default rates
  - Lead generators important
  - Unlicensed less likely to follow regulations
  - Troublesome consumer practices found in US study, e.g., repeat borrowing default

# Consumer behaviour issues

- Recent literature considers the rationality of using payday lending
  - Use of behavioural economics to investigate tunneling as a type of scarcity
  - Important implications for marketing and accessibility of different types of banks and banking services

# Consumer behaviour issues

- Literature on concept and measurement of financial literacy adds further insight into this issue
  - Some studies have found that payday loan use, or financial exclusion more generally, are higher for people with lower financial literacy
  - Results demonstrate correlation not causation
  - And note correlation with lower income and assets

# Regulatory changes and the impact of payday loan regulations on consumers

- Regulatory regimes: permissive, hybrid & restrictive
  - US states mixed
  - Canadian provinces mainly hybrid/permissive
- Innovation in US regulation: e.g., CFPB proposal, Colorado regulations

# Regulatory changes and the impact of payday loan regulations on consumers

- Price cap impact: fees move to the cap
- Limits on amount borrowed: evidence that without more binding limits these limitations have limited effect
- Rate caps and payday loan use:
  - Limited evidence that restrictive caps do not lead consumers to reliance on underground money lending

# Method of Acquiring Payday Loans by State Law Type

Percentage of adults reporting payday loan usage in the past 5 years

Source: Pew Charitable Trusts 2014.

	Borrow from storefront only (%)	Borrow from online or other (%)
National	4.01	1.48
Permissive states	5.22	1.37
Hybrid states	5.06	1.28
Restrictive states	1.29	1.58

## Discussion

- The literature on payday lending find that it mature and faces chronic challenges
  - Repeat borrowing continues to be a major concern and this problem is well documented in the US.
  - Repeat borrowing points to the need for additional regulation of the sector to protect the repeat borrower
- Data on the issue in Canada are sufficient to demonstrate that action is needed

## Discussion

- While there are limited data about online lending, what data are available does point to higher risks for consumers.
- However, this should not, however, be used as a rationale to not regulate physical payday lending.
- Both sectors must be effectively regulated.

## Discussion

- In Canada we need more data to determine the extent of the problem.
- There is a clear need for government to collect these data so that careful analysis can be done.
- Federal agencies such as the Financial Consumer Agency of Canada and/or the Industry Canada-based Consumer Measures Committee are obvious choices to take on this task.
- The Manitoba Consumers Bureau has membership on the CMC.

## Discussion

- The state-based and varied regulation of the payday loan industry in the US has led to a number of interesting studies.
- While impact assessments cannot definitively determine whether or not payday loans benefit consumers it is clear that some consumers – relying on repetitive borrowing, accessing their loans online, tunneling as a result of personal and professional pressures– may be harmed by payday loans.

## Discussion

- This situation calls for continued regulation of payday lenders.
- It also suggests government should be carefully examining other fringe financial institutions such as Rent-to-Owns
- Moreover, efforts to fill the banking service gap that payday lenders are filling must be addressed by mainstream banks, e.g., through the Access to Basic Banking regulations
- Finally, consumer education that draws on the insights from behavioural economics is clearly in order.