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After Payday Loans: How do Consumers Fare When States Restrict High-Cost Loans?

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Payday lenders offer fast cash loans that do far more harm than good, putting people in a cycle of debt. Payday lenders charge rates that can reach 200% APR or higher and rely on the ability to coerce payments rather than borrowers' ability to repay. Fifteen states and the District of Columbia effectively cap the costs of short-term payday loans,[1] and others are considering doing so as the harms have become more and more apparent. The vast majority of the states also have rate limits for long-term loans.

Once a state limits the interest rates on payday loans, what is the impact on consumers?

In state after state, the impact is clear: consumers are better off without payday loans and find better ways to cope with financial challenges:

- Former borrowers generally agree that they are better off without payday loans and express relief that the loans are no longer available.
- People use a variety of strategies to manage their finances, including borrowing from family and friends, negotiating payment plans with utility companies, and using pawn shops or traditional credit products like credit cards.
- Consumers do not turn to illegal internet loans in large numbers.

The solution to a financial challenge is not to create a financial disaster by charging a consumer triple digit interest and trapping them in a cycle of debt. There is no easy answer to lack of money, but in states that restrict high-cost loans consumers have successfully deployed better strategies. Of course, if consumer protection laws have gaps or allow other predatory products to remain, lenders may attempt to exploit those loopholes. But other problems in the financial marketplace should not stop policymakers from tackling loans that do more harm than good.

This issue brief focuses what happened in states that previously allowed high-cost payday lending and then adopted or enforced an interest rate cap of 36% or less.[2] Other research has also shown that consumers are better off in states that have never allowed payday lending.[3]

Arkansas

Payday Free: 2008[4]; Restriction: 17% annual interest rate[5] *Estimated Annual Payday Fee Savings*: $77,504,338[6]

- **Arkansas Supreme Court Upholds Constitutional Usury Limits**: The Arkansas Constitution caps interest rates at 17%, but the legislature passed a law attempting to carve out an exception for short-term payday loans with rates exceeding 300%. In 2008, the Arkansas Supreme Court found the law was unconstitutional and all payday stores were closed by 2009.[7]
- **Arkansans Better Off Without Payday**: Most respondents to a Southern Bancorp survey of 100 former payday borrowers (59%) who had lodged complaints with AARP and/or the Attorney General's office indicated that they were better off after payday was banned. Borrowers reported that the ease and availability of the loans was ultimately what made payday loans attractive, but that the accompanying debt trap caused stress and anguish along with a ripple effect of ancillary hardships and financial distress with other vendors, companies, service providers, etc. One respondent noted: *"I found that I really could do without them. I work terms with my creditors. They are willing to accept something from you. I have actually paid off debts by a little at a time. I keep more money in the home and not having to pay back loans that triple the amount borrowed."* [8]
- **Borrowers in Arkansas Adapt to Less Risky Credit Sources**: Respondents to the survey indicated a wide range of alternatives to payday loans they had used after payday loans were banned. The three most popular alternatives were: Friend/Family Loan (36), Credit cards (21), Pawn Shops (19).[9]
- **Consumers Did Not Generally Turn to Illegal Internet or Border State Loans**: Southern Bancorp also conducted a survey of credit counselors (fourteen counselors responded, seven of whom had been counselors since at least 2008). The survey found that clients had more payday loans in 2008 than in 2014, suggesting that use declined after the ban despite the availability of internet and border state payday loans.
- **Overall Debt Load Remains Stable**: The credit counselors surveyed also reported that the overall debt load for consumers in 2014 compared to 2008 "remained the same or increased somewhat." The studies' authors suggested that a number of factors prevented debt loads from declining, including failure of income to track the cost of living, as well as the mortgage crisis and recession in the years following the 2009 ban of payday. [10]

Georgia

Payday Free: 2004; *Restriction*: Payday loans are banned[11] *Estimated Annual Payday Fee Savings*: $284,112,449[12]

- **Georgia Lawmakers Impose Criminal Penalties on Payday Lenders:** While payday lending was effectively restricted by the Georgia Industrial Loan Act of 1955, which required licensing and imposed rate caps,[13] the Georgia Assembly determined that rent-a-bank arrangements were being used to circumvent restrictions on payday lending[14].

In 2004, the Georgia legislature passed the Payday Lending Act of 2004 which, among other things explicitly banned rent-a-bank arrangements,[15] prohibited loans of less than $3,000 that did not comport with existing law (including those relating to interest and usury)[16] and established penalties of 1 year in prison, a fine not to exceed $5,000, or both.[17]

- **Involuntary Bank Account Closures in Georgia Declined After Payday Ban:** Relative to counties in bordering states, a 2012 study found that, after the payday loan ban, Georgia counties within 60 miles of a state border experienced an over 9% decline in the mean rate of bank account closures, and counties more than 60 miles from a border (during the study period all bordering states allowed payday lending)[18] experienced an over 30% decline in the mean bank account closure rate.[19] Study authors found that this decline was "consistent with the "debt trap" critique of payday lending where the practice leads to increased rates of involuntary bank account closure."[20]
- **Work Remains to Eliminate other Predatory Loans:** A recent study found that car title lenders, who can still charge interest rates as high as 300%, had 755 locations in Georgia in 2018 with over 74% of them in areas with a poverty rate above the national average.[21]

Montana

Payday Free: 2010; *Restriction*: 36% annual interest[22] *Estimated Annual Payday Fee Savings*: $20,750,969[23]

- **Montanans Overwhelmingly Vote to End Payday:** A 2010 ballot measure, approved by 73% of those voting, created a 36% interest rate cap for loans that had previously been as high as 500%.[24]
- **Usage of Low-Cost Credit Union Loans Increases:** During the campaign for the interest rate cap in Montana, Montana Credit Unions for Community Development launched a campaign to make people aware that credit unions offer better alternatives to payday loans. Twelve credit unions tracked Payday Alternative Loan use during and after the campaign and found an over 24% increase in usage for July through September 2010, and an over 26% increase for October through December 2010.[25]
- **After a Temporary Adjustment, Consumers Avoid Online Lenders**: Complaints to the Attorney General about online payday lenders temporarily spiked after the interest rate cap went into effect, with 103 complaints in 2013. But this was likely a temporary adjustment period for consumers who were looking for ways to roll over unaffordable payday loans. Complaints later plummeted, and in 2016 there were only seven complaints against payday lenders.[26] This adjustment period seems to confirm previous research that determined that rates of online payday borrowing were not significantly higher in states with no storefront payday lenders (1.58%) than in states that allow payday lending at triple digit rates (1.37%).[27]

New Hampshire

Payday Free: 2009; *Restriction*: 36% annual interest[28] *Estimated Annual Payday Fee Savings*: $27,390,363[29]

- **NH Legislature Finds Payday Interest Unreasonable and Predatory**: New Hampshire (NH) had a small loan interest rate ceiling until it was removed in January 2000.[30] However, in 2008 (law effective 2009) the New Hampshire legislature found that "the rates of interest charged by many title loan lenders and payday lenders are unreasonable and predatory" and capped the annual percentage rates at 36%.[31]
- **New Hampshire Former Payday Borrowers Are "Glad They're Gone"**: In a focus group of 10 former NH storefront payday borrowers conducted by Pew, participants mostly expressed relief that the lenders were gone although some acknowledged they would likely use the loans again if the stores returned. Former borrower comments include:
    - *"I'm glad they're gone. I hope they never come back."*
    - *"I think they need to find other ways to help people out than just make it so easy to do that, because that's why people do it."*
    - "*They're out, leave them out, and you know what I mean? Then you don't have to worry about it."*
    - *"[Now that payday lenders are gone] you can't get stuck in it."* [32]
- **Former Borrowers Develop New Strategies**: In a 2011 Pew survey former payday loan borrowers discussed a variety of strategies they employ now that NH is payday-free, including "rebudgeting, prioritizing bills, pawning or selling belongings, borrowing from family members, or, as one borrower stated, working out 'payment plans with utility companies.'"[33]

North Carolina

Payday Free: 2001 to 2006; Restriction: 36% annual interest[34] *Estimated Annual Payday Fee Savings*: $255,144,890[35]

- **North Carolinian Legislators Realize Their Mistake in Authorizing Payday Loans:** From 1997 to 2001, North Carolina authorized payday loans by exempting them from usury limits. The state allowed the law authorizing payday loans to sunset in 2001, and in March 2006 the remaining payday lender chains that were operating in partnership with out of state banks entered into a consent agreement with the Attorney General and ceased to operate.[36]

- **North Carolinians Positively Impacted by Payday Ban:** In a 2007 report designed, among other things, to determine the effect the end of payday lending had on low- and middle-income households. Twice as many surveyed former payday borrowers reported that the absence of payday had a positive rather than a negative impact on their household.[37]
- **Consumers Develop New Strategies**: The 2007 report also found that the vast majority of households surveyed use a variety of options to manage shortfalls and the loss of any one option (like payday) impacted few.[38] But some borrowers were impacted by the continuing availability of other forms of predatory lending (not generally within the scope of small dollar high cost lending regulation), such as overdraft loans and EZ leases for appliances secured by postdated checks.[39]
- **Credit Unions Step In With Lower Cost Options:** In 2001, when the payday authorizing law was allowed to sunset, the State Employees' Credit Union launched its Salary Advance Loan and Savings program (SALOS), an open-ended line of credit up to $500 with rates between 5.75% and 12.25% and no fees and a savings component.[40] The program has grown in volume from nearly 24,000 members in 2003[41] to 200,000 members who are either actively using the program or have moved their funds to a traditional savings account and exited the program in 2016.[42]
- **Other Products Supply Credit after Restriction of Payday:** After the law authorizing payday lending was allowed to sunset in 2001, the number of loans under $600 made by finance companies increased 37% in the four years from 2002 to 2006.[43] In recent years, the number of finance company loans under $600 has dropped[44] although ultimately this may be a positive shift as these loans are not without their own problems[45] and better alternatives exist.

Conclusion & Recommendations

In states that expel predatory lenders, consumers are relieved that those lenders are gone and adapt by employing a variety of strategies ranging from budgeting, to pawning an item, to borrowing from family. In many payday free states, however, the work is not done as predatory lenders exploit legal loopholes to target vulnerable populations with high-cost products such as overdraft loans, installment loans, or auto title loans. Additionally, payday loan bans must be carefully crafted to avoid creating loopholes that allow lenders to trade one set of predatory practices for another. Policymakers should feel confident that payday bans will benefit their constituents and work with local and national advocacy groups to craft the strongest bans possible.

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Endnotes

[1] Arizona, Arkansas, Connecticut, Georgia, Maryland, Massachusetts, Montana, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, South Dakota, Vermont, Washington D.C., West Virginia. *See* Map of U.S. Payday Interest Rates, Center for Responsible Lending. http://bit.ly/2MVERaO. Many more states impose interest rate caps on longer term loans. *See* Carolyn Carter et. al, National Consumer Law Center, Predatory Installment Lending in 2017: States Battle to Restrain High-Cost Loans (August 2017), http://bit.ly/2PPjyGv.

[2] As the focus of this brief is examining the impact on consumers after states become payday free, it does not attempt to compile every academic paper addressing the potential impacts of payday bans or comparing payday free jurisdictions with states that allow payday lending, but rather focuses on the impact on consumers after a state transitions to payday free.

[3] See Center for Responsible Lending, Shark-Free Waters: States are Better Off without Payday Lending (Aug. 17, 2016) (updated Sept. 2017), http://bit.ly/2LylQqf

[4] The Arkansas Supreme Court ruled that the law authorizing payday lending was unconstitutional in 2008, though the legality of the practice was unclear as early as 2001. Neil Bhutta, Jacob Goldin, Tatiana Homonoff, Consumer Borrowing After Payday Loan Bans, February 5, 2016, pg. 8, Fn. 9. http://bit.ly/2kZKPI9

[5] Covington, Johnson, Southern Bancorp Community Partners, Into the Light: A Survey of Arkansas Borrowers Seven Years after State Supreme Court Bans Usurious Payday Lending rates, Southern Bancorp at 4 (April 2016) ("Into the Light"), https://banksouthern.com/sbcp/into-the-light/. See McGhee v. Arkansas State Bd. of Collection Agencies, 289 S.W. 3d 18, 2008. http://bit.ly/2nTMUXx

[6] Center for Responsible Lending, Shark-Free Waters: States are Better Off without Payday Lending, Pg. 9, Figure 1, (Aug. 17, 2016) (updated Sept. 2017), http://bit.ly/2LylQqf

[7] Into the Light. at 4.

[8] Id. at 5, 6.

[9] Id. at 7.

[10] Id. at 9.

[11] OCGA § 16-17-1(e) reiterating that payday lending is illegal in Georgia. OCGA § 7-4-18(a) also establishes a criminal usury cap of 60%. *See* Making Small-Dollar Lending Safer for Georgians, Georgia Watch and Georgia Financial Protection Coalition, 2018. http://bit.ly/2PeMkiD

[12] Center for Responsible Lending, Shark-Free Waters: States are Better Off without Payday Lending, Pg. 9, Figure 1, (Aug. 17, 2016) (updated Sept. 2017), http://bit.ly/2LylQqf

[13] Georgia Department of Law, Consumer protection Unit, A-Z Consumer Topics, Payday Loans. http://bit.ly/2MkhqHL

[14] OCGA § 16-17-1(c) "The General Assembly has determined that various payday lenders have created certain schemes and methods in order to attempt to disguise these transactions or to cause these transactions to appear to be "loans" made by a national or state bank chartered in another state in which this type of lending is unregulated, even though the majority of the revenues in this lending method are paid to the payday lender."

[15] OCGA § 16-17-2(b)(4)

[16] OCGA § 16-17-2(a)(1)(E)

[17] OCGA § 16-17-2(d)

[18] D. Campbell et al., Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures, Journal of Banking & Finance, 36 (2012) 1224–1235, 1231.
[19] Id. at 1232
[20] Id.
[21] Making Small-Dollar Lending Safer for Georgians, Georgia Watch and Georgia Financial Protection Coalition, pg. 3, 2018. http://bit.ly/2PeMkiD
[22] Neil Bhutta, Jacob Goldin, Tatiana Homonoff. Consumer Borrowing After Payday Loan Bans, February 5, 2016, pg. 8. http://bit.ly/2kZKPI9
[23] Center for Responsible Lending, Shark-Free Waters: States are Better Off without Payday Lending, Pg. 9, Figure 1, (Aug. 17, 2016) (updated Sept. 2017), http://bit.ly/2LylQqf
[24] Matt Volz, Montana voters approve payday loan, real estate tax initiatives, Missoulian, Nov. 3 2010. http://bit.ly/2KqQ7rb
[25] Passman, Wack, CUs Skeptical About Expanding Colorado's payday Loan Law Nationwide, Credit union Journal, Dec. 3, 2014. http://bit.ly/2KvBbbt
[26] Liz Farmer,The Myth vs. the Truth About Regulating Payday Lenders, Governing the States and Localities, March 2017. http://bit.ly/2MqWMSE
[27] Bourke, Horowitz, Roche, Payday Lending in America: Who Borrows, Where They Borrow, and Why, Pew Charitable Trusts, July 2012, pg. 23. http://bit.ly/2Mr1xM0
[28] Neil Bhutta, Jacob Goldin, Tatiana Homonoff. Consumer Borrowing After Payday Loan Bans, February 5, 2016, pg. 8. http://bit.ly/2kZKPI9
[29] Center for Responsible Lending, Shark-Free Waters: States are Better Off without Payday Lending, Pg. 9, Figure 1, (Aug. 17, 2016) (updated Sept. 2017), http://bit.ly/2LylQqf
[30] Melzer, Morgan, Competition in a Consumer Loan Market: Payday Loans and Overdraft Credit, May 14, 2013, pg. 38. http://bit.ly/2tPcBek *See* SB 99 ch. 248 (1999). http://bit.ly/2tN1pyU
[31] HB 267 ch. 301 (2008) http://bit.ly/2tWlO4B
[32] Urahn, Plunkett, How Borrowers Choose and Repay payday Loans, Feb. 2013, pg. 51. http://bit.ly/2KCjDxC
[33] Bourke, Horowitz, Roche, Payday Lending in America: Who Borrows, Where They Borrow, and Why, Pew Charitable Trusts, July 2012, pg. 17. http://bit.ly/2Mr1xM0
[34] North Carolina Consumers After payday Lending: Attitudes and Experiences with Credit Options, November 2007, pg. 21. (North Carolina Consumers) https://unc.live/2lGy0To
[35] Center for Responsible Lending, Shark-Free Waters: States are Better Off without Payday Lending, Pg. 9, Figure 1, (Aug. 17, 2016) (updated Sept. 2017), http://bit.ly/2LylQqf
[36] North Carolina Consumers at 22. https://unc.live/2lGy0To
[37] Id. at 1.
[38] Id.
[39] Id. at 17.
[40] State Employees' Credit Union, Response to Payday, Vehicle Title and Certain High-Cost Installment Loans Proposed Rule, Docket # CFPB-2016-0025, Oct. 5, 2016, pgs. 1-2.
[41] Credit Union Times, SECU of North Carolina Expands Salary Advance Loan Program to Encourage Saving, Feb. 18, 2003. http://bit.ly/2OpkjER
[42] State Employees' Credit Union, Response to Payday, Vehicle Title and Certain High-Cost Installment Loans Proposed Rule, Docket # CFPB-2016-0025, Oct. 5, 2016, pg. 3.
[43] North Carolina Consumers at 20.

[44] North Carolina Commissioner of Banks, Consumer Finance Annual Report, 2016, pg. 14. http://bit.ly/2KtHTli

[45] Kelly Tornow, Center for Responsible Lending, Alfred Ripley, NC Justice Center, Comment on Proposed rulemaking for consumer finance licensees and objections to 04 NCAC 03E .0601(8)(a) through (e), June 1, 2018, pg. 3. http://bit.ly/2Opx0PX