Assessing the Impact of Payday Lending De-Authorization

05/13/08

Presented by Kim R. Manturuk, Center for Community Capital

University of North Carolina at Chapel Hill

Mr. Chairman, members of the Committee:

Thank you. We're always gratified when people are interested in our work. At the Center for Community Capital at the University of North Carolina at Chapel Hill, we study the role of capital in building wealth in ways that are viable from a business perspective. In 2007, at the request of the North Carolina Office of the Commissioner of Banks, the Center conducted research on how the de-authorization of payday lending in North Carolina affected low- and middle-income state residents. Our objective was to evaluate whether the availability of credit options for working families had been curtailed by the de-authorization of payday lending. You have a copy of this study which I will summarize in my comments today.

First, a brief history of payday lending in North Carolina so you can put our experiences in context:

> In 1997, payday lending was exempted from state usury regulations which cap the annual percentage rate on loans under $300 at 36%. In its Declaratory Ruling, the Commissioner of Banks said that payday lending was to be "given an experimental period ... to determine …its effect upon the consuming public."
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> Payday lending in North Carolina peaked in the year 2000 when over 1,000 locations

made 3.5 million loans to 431,000 people.[1] Customers taking out 6 or more payday loans a year generated 85% of the volume. The average payday borrower got more than eight loans in 2000 (from the same store). 18% of customers used the same lender more than once per month - that's almost 20% going at least 12 times a year.[2] Net charge offs of less than 2% of loans advanced. That's how it looked in our state.

Ultimately, the practice was not considered beneficial enough to the "consuming public" to warrant extending the exemption, so it was allowed to expire in Aug., 2001. Some lending continued through partnerships with out-of-state banks, but in 2004 these partnerships were ruled illegal and the remaining chains left the state under consent decrees with the state Attorney General in 2006.

One year later, the Commissioner of Banks asked us to evaluate the effect that payday de-authorization had on the people of our state. Was the net impact negative, neutral or positive? Were a significant number of households suffering as a result of the loss of storefront payday lending, or did they have adequate alternatives to make ends meet? Much as you're asking, *How will people cope?,* we were asked *"How are people coping?"*

To answer these questions, we surveyed 400 individuals making no more than $45,000, with regular income and a bank account - people most closely fitting the profile of a potential payday borrower. We used a random cluster sample of residents living in the three urban areas which formerly had the highest concentration of payday lending outlets in the state (Charlotte, the largest city; Raleigh, the capitol; and Fayetteville, home

1 NC Commissioner of Banks, 2000 Annual Report of Check Cashing Businesses Licensed Under Article 22 of Chapter 53 of the North Carolina General Statutes Fact Sheet.

2 North Carolina Commissioner of Banks (NCCOB). 2000. *Annual report of check cashing businesses licensed under article 22 of chapter 53 of the North Carolina general statutes fact sheet.* Raleigh, NC: NCCOB. In 2000 in North Carolina, there were 3,469,917 loans made to 413,214 customers for an average of 8.4 loans per customer per store.

of the Fort Bragg military base). We asked if the household had recently experienced a financial shortfall - 159 respondents had. We then asked a series of questions about what tools they used to make ends meet; we asked the same set of questions about all options used. The survey was not payday loan specific until the closing questions, where we asked all respondents what they thought of de-authorization of payday lending and how it had affected them.

Our key findings are summarized in the report and are as follows:

With or without payday lending, **People have many strategies and options for handling shortfalls and are generally not relying on one single source of credit.** The 159 households we surveyed who had experienced a recent financial shortfall used an average of between 2 and 3 credit alternatives during their most recent shortfall. People preferred the low- and no-cost options. The top three answers, pay late/not pay, use savings, or borrow from friends/family, accounted for more than half the resources cited. The least-used options were the costliest ones: auto title loans, bankruptcy, payday loans, and tax advance loans.

Payday lending has not been missed in North Carolina

Almost 60% of the people we surveyed were not aware that payday lending was not allowed in North Carolina. When we asked people, “Is payday lending a good thing or a bad thing?”, nearly nine out of ten households surveyed said it was a bad thing; this was true among the full sample of 400 and also among the 159 people who had experienced a shortfall. **Even among those 23 who had previously used a payday loan, three-quarters said it was a bad thing.**

We also asked people about the effect that prohibiting payday lending had on their household.

a) Over 70% said it had no effect at all.
b) For those who said it did affect them, we asked whether the effect was positive or negative. By a margin of more than 2:1, they said the effect of prohibiting payday lending on their household was **Positive** rather than negative. Again this held true for all respondents and for former payday borrowers. The biggest gap (>3:1) positive to negative was among those 159 household experiencing a recent financial shortfall. **To emphasize, the households most likely to have needed a payday loan were also the most likely to feel that not being able to get one was a positive thing.**

We also conducted focus groups of 20 payday borrowers, detailed in the report. We spoke with a group of ten infrequent customers who had procured 5 or fewer loans, and a group of ten frequent customers who had more than five loans. Focus group participants were recruited from a volunteer database maintained by the independent research firm we contracted to moderate the groups. The sole criteria for participation was that respondents had to have taken a payday loan at some point in the prior 5 years. These focus groups allowed us to hear the experiences of actual borrowers -- before and after payday lending -- in their own words

Here's what we heard: We heard how the undeniable ease of obtaining a loan attracted them to the product. This is consistent with research from the industry that has found that users report the highest satisfaction with the application process and ease of obtaining the loan, and that the single most important reason for obtaining a loan is speed and ease, whereas only 9% are reported to have said they had no alternative. But we also heard that it was often very difficult to get out of the loan. Most customers we spoke to rolled their loans over many times before finally paying off,. As one said "It is really easy. You just go down and give them another $30 and you have another two weeks to pay it back." All but one person reported paying off all their loans. The overwhelming majority were relieved that they no longer had the option to take a payday loan.

One of our objectives was to determine how working families manage financial shortfalls, particularly since payday lending was banned.

Not paying or paying late was the most common survey response given. Using savings was the second most popular survey response, typically in combination with other alternatives. What we heard from the focus groups was that some former payday borrowers were managing their money differently by being more thrifty or setting aside more for emergencies. Turning to friends and family was the third most popular survey response. North Carolina residents also used a wide variety of other credit options - the survey respondents reported using 11 additional credit options.

We asked survey respondents to rate the satisfaction and fairness of each option they used (p 10), and you can see that payday lending was tied for least fair among all options.

As alternatives, there are two major developments in North Carolina worth noting. First our state employees' credit union, the second largest in the country, offers a two week payday advance loan at 12% APR and is finding it to be both profitable and popular. It requires borrowers to deposit 5% of the loan proceeds in a savings account. Typical loan customers earn less than $25,000 per year and have low credit scores, but they accumulated $8 million in savings in the first five years that this product was available.

Also, the finance companies reported a sharp increase in the number of small loans made since the end of payday lending. These loans are capped at 36% APR and offer longer repayment terms than the typical 2-week term of a payday loan. While only a handful of the people we surveyed had taken a finance company loan, they outranked all other options in terms of perceived fairness to the customer.

In conclusion:

The objective of our research was to determine how low- and moderate-income families in North Carolina we affected by the de-authorization of payday lending in our state. We found that the vast majority of North Carolinians felt payday lending was a bad thing and don't miss it. Among households who feel they have been affected by de-authorization, most say they are better off now. We also found that the de-authorization of payday lending has not curtailed the availability of credit for working families in our state, and most families are aware of a wide range of options for managing financial shortfalls.

So the de-authorization of payday lending in North Carolina has been a good thing, right? Well, not everyone thought it was good. There will always be the payday borrower who feel they benefited, the subprime borrower who was finally able to buy - and maybe even keep - a home of their own, the driver who survived a wreck because he *wasn't* wearing a seatbelt - and there will always be lots of stories on the other side too. Our research sought to get past anecdotal evidence and individual cases to establish a public policy framework for assessing the aggregate affect of payday lending.

At the same time that we heard that people don't miss payday loans, we also heard that demand remains strong for alternative sources of small, affordable consumer loans.
What to make of this? The concern that people will not have a way to meet their financial

needs if they don't have payday lending relies on the implicit assumption that payday loans do address their needs. Our research indicates that **payday lending did not fulfill this demand in North Carolina, as few people miss it now that it is gone and even those who frequently took payday loans feel that they are better off without the option.**