Payday Lending Supporters Promote Flawed Analysis to Justify Predatory Interest Rates

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A report released in January of 2023 attempts to provide cover for the predatory practices of payday lenders, who charge average 400% annual interest on loans that routinely create a long-term cycle of debt that sends borrowers into deep financial insecurity.

The Consumer Financial Protection Bureau (CFPB) found that 75% of payday lender fees are collected from borrowers with 10 or more loans per year, indicating the reliance of payday lenders on a business model of long-term debt.

Eighteen states and D.C. have stopped this debt trap by implementing a rate cap of 36% or less, including fees. Illinois passed such a cap in 2021. This has prompted supporters of payday lending to take aim at the new law, making the unsubstantiated claim that consumers will suffer if triple-digit interest loans are not available in their states.

Quote from Adam Levitin, Professor of Law at Georgetown University

"A self-reported survey administered by self-interested lenders is an unreliable method for determining the PLPA's [Predatory Loan Prevention Act] effect on consumer welfare. There is no reason to believe the survey responses are representative. The survey was only of consumers who borrow online, a population with particularly poor credit, and the response rate was less than 3% raising serious concerns about selection bias. Nor did the survey attempt to control for macroeconomic conditions, such as the pandemic or inflation. Most importantly, the survey cannot provide casual evidence about the impact of the PLPA."

Source: "Impact of the Illinois Predatory Loan Prevention Act," Credit Slips, January 15, 2023

But an analysis by CRL of the structure and methodology of research cited by supporters of payday lending found multiple flaws that raise questions about the objectivity and validity of the conclusions presented in the report.*

Research Design Flaws

The report claims the Illinois interest rate cap caused a decrease in the availability of small-dollar credit. However, a decrease in the amount of harmful, high-interest lending in Illinois was to be expected and is what the law intended.

Limitations in the research show the report does not provide an accurate view of the overall small dollar lending market at all. For example, the researchers use credit reporting data to measure lending rates, but some types of small dollar loans are not reported to credit bureaus. Additionally, the analysis of credit availability does not provide any information about whether a decrease in subprime lending is helpful or unhelpful to consumers. To make the claim that such a decrease is unhelpful, the report uses responses from a survey administered by the Online Lenders Alliance (OLA), which represents high-interest lenders and has lobbied against rate caps for years.

* Despite the fact that one of this paper's authors is a member of the Federal Reserve's Board of Governors, the deeply flawed report is not a product of the Federal Reserve Board, as acknowledged by the authors.

As Levitin points out in the quote above, relying on high-interest lenders for data on the impact of rate caps to consumers is misleading. The OLA survey findings are weak and potentially biased due to the survey's low response rate and selective reporting. And beyond this, the researchers use the survey results to comment on the experience of subprime borrowers in particular, despite reporting findings for the whole sample, not just that subset of borrowers.

The report also claims the interest rate cap causes a decrease in credit availability by comparing Illinois to Missouri, which does not have a rate cap. Since the researchers do not provide credible evidence that a drop in subprime lending rates would negatively impact consumers, the analysis lacks relevance. Additionally, the methodology used for this comparison shows weaknesses that cast further doubt on the soundness of the report and its conclusions.

The report authors describe the comparison of the two states as a "difference-in-differences approach," a statistical technique allowing researchers to claim causation rather than just correlation. In this case, they compared lending rates in Missouri and Illinois before the Illinois rate cap was implemented and after, and attributed a change in lending rates they claim to have found in Illinois to the rate cap.

However, the researchers did not thoroughly examine other factors that reasonably might have impacted lending rates, such as whether the COVID-19 global economic crisis might have affected these two states differently. This is a plausible reason for the changes, as cited by a leading database provider for payday and installment lenders.

They also did not strengthen their analysis by showing that patterns remained the same when expected. For example, they suggest that residents of Illinois counties bordering Missouri could cross the border to get credit if they wanted, but they do not actually report on any movement patterns of Illinois border county residents. They provide no data to support the suggestion.

Other examples of flaws in the basic research methods:

- In the Illinois/Missouri comparison, only unsecured installment lending rates were measured, which reveal nothing about overall credit availability.
- The reported data is aggregated in ways that likely mask important details. For example, rather than show trends for each of the four quarters for which they have data, they show just two, likely making trend lines look like a smooth trajectory, when more data points might reveal more variation.
- Tables 6 & 7: Despite modeling with quarterly data, the report authors selectively omit Quarter 1 data from the table, making it difficult to validate their claims about parallel trends.

Faulty Premise

We know that high-cost lending tends to burden consumers with unaffordable debt and cause financial problems for borrowers. Arguing that a drop in high-cost credit is harmful to consumers, with no evidence of harm other than a poorly administered survey from high-cost lenders themselves, is irresponsible and ignores the plight of the millions of Americans caught in unaffordable debt.