CRL Critique of "Payday Holiday: How Households Fare After Payday Credit Bans" by Donald P. Morgan and Michael R. Strain

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In a recent working paper, Donald Morgan, a researcher affiliated with the New York Federal Reserve and Michael Strain, a Cornell University graduate student, attempt to determine whether households in two states which have outlawed payday lending (North Carolina and Georgia) have fared better than households in states in which payday lending is still authorized. The authors analyze patterns of returned (bounced) checks, complaints filed with the Federal Trade Commission (FTC) against lenders and debt collectors, and federal bankruptcy filings, and conclude that "Georgians and North Carolinians do not seem better off since their states outlawed payday credit."

The authors contend that Georgia and North Carolina residents (1) had greater rates of returned checks than the national average; (2) complained more to the FTC about lenders and debt collectors; and (3) filed for Chapter 7 bankruptcy at rates greater than the national average.

However, Morgan and Strain's data and research methods are not adequate to support these findings or overall conclusion. The authors consistently intermingle data from Georgia and North Carolina—which outlaw payday lending—with data from states which allow it. They also ignore important data that does not support their arguments.

- The returned check data used to report increases for Georgia and North Carolina after payday lending was banned includes not only these two states, but also returned checks from Alabama, Louisiana, South Carolina, southern Mississippi, and Tennessee—states where payday lending is legal. The authors did not separate out Georgia and North Carolina-specific data from these others states which allow payday lending.

- The assertion that borrowers have no other alternative to payday loans than to bounce a check, is in direct conflict with academic and industry research showing a variety of less expensive alternatives for dealing with a financial shortfall.

- While FTC complaints increased after payday lending was banned in Georgia, the District of Columbia actually experienced the highest rate of complaints—a jurisdiction that—until 2008—had almost no limitations on payday lending.

- In analyzing variances in bankruptcy rates among states, the authors fail to account for several factors that greatly influence a person's chances of filing for

bankruptcy protection, including health insurance coverage, foreclosures, divorce rates, and demographic factors such as income.

These and other flaws in this study's conclusions are discussed in more detail below.

Returned check data

The returned check data used to report increases for Georgia and North Carolina after payday lending was banned includes not only these two states, but also returned checks from Alabama, Louisiana, South Carolina, southern Mississippi, and Tennessee—states where payday lending is legal. The only point demonstrated by this data is a slightly higher number of returned checks for people living in the much of the southeastern region of the United States, relative to the national average.

In analyzing returned checks, the authors use data from the Federal Reserve's *regional* check processing centers (CPCs) as proxies for *state* credit markets. However, the regional CPCs in Atlanta and Charlotte handle checks for other states besides Georgia or North Carolina, including states that allow payday lending. For example, more than half of the checks processed at the Charlotte center come from South Carolina, home of Advance America's headquarters and over 1,000 payday lending storefronts.[1] Similarly, during the aftermath of Hurricane Katrina, checks from those areas affected began to be processed in the Atlanta center.[2] Atlanta's CPC also serve Alabama and Tennessee, additional states with payday lending locations. Because the CPC data includes returned checks for states that authorize payday lending, one cannot draw the conclusion that a payday lending ban results in higher rates of returned checks.

Atlanta check processing center processes returned checks from:		**Charlotte check processing center processes returned checks from:**	
Alabama, Louisiana, southern Mississippi, and Tennessee (payday lending legal)	Georgia (payday lending banned)	South Carolina (payday lending legal)	North Carolina (payday lending banned)

Even if we were to accept this data as a valid proxy for conditions in Georgia and North Carolina, the increased rate of returned checks is minuscule—in Atlanta's worst quarter after the payday ban, they had two-tenths of one percent more returned checks than the national average. In other quarters, they were actually below the national average. Charlotte's CPC has had fairly consistent above national average rates ranging from 0-0.4% throughout the study period, *before, during, and after* payday lending was legal in North Carolina.

Finally, the authors erroneously assume that bounced checks are the *only* substitute for a payday loan: "Of course, households in Georgia and North Carolina had only one choice once payday credit was banned. If we observe higher bounced checks afterwards, it tells us payday credit was the preferred choice..." But a recent study by the University of

North Carolina found that former payday borrowers use a host of options to cover financial shortfalls, such as working out delayed payments with creditors; borrowing from family, friends, or employers; dipping into savings; or delaying a purchase for a short period of time.[3] In addition, Pat Cirillo of Cypress Research, who frequently conducts borrower surveys for the industry, has found that over half of payday borrowers have a credit card that they could instead use for a financial shortfall.[4]

FTC complaint data

In analyzing complaints to the FTC, the authors find that people in Georgia complain more to the FTC than those in other states. However, this was the case before and after the payday lending was halted in 2004, with a steady upward trend beginning in at least 1997.[5] In addition, the authors find Georgia has the second highest rate per capita of FTC complaints per year, they note that the jurisdiction with the highest complaint rate was the District of Columbia. Yet during the time period for this research, the District of Columbia had some of the loosest restrictions on payday loans of any state. This appears to refute the authors' attempt to develop a cause/effect relationship between the absence of payday lending and FTC complaints.

Moreover, the authors admit that the rate of FTC complaints from households in North Carolina is *not* higher than complaint rates in other states. The data does show a steady *national* increase in FTC complaints for some time but especially since 2001. Many experts have attributed this to rise of identity theft; this is confirmed by the FTC as over 40 percent of all complaints involve challenging the actual validity of the debt. We are not aware of even a potentially plausible relationship between payday lending and identify theft.

What sorts of financial services state residents were using also affects the number of complaints logged by the FTC. For example, a consumer wishing to complain about high credit card fees would log their complaint with the FTC. However, a person wishing to complain about a 391% APR payday loan and payday lender debt collection tactics would likely direct their complaint to a state regulator.

Regardless, the authors' conclusion that a person taking out a payday loan "helps avoid…getting hassled at work by debt collectors" completely ignores the aggressive tactics used by payday lenders, including frequent phone calls to the borrower and their employer, family, and friends. In fact, the majority of complaints filed against payday lenders are regarding debt collection practices. [6]

Bankruptcy data

In analyzing variances in bankruptcy rates among states, the authors fail to account for several factors that greatly influence a person's chances of filing for bankruptcy protection, including health insurance coverage, foreclosures, divorce rates, demographic factors such as income. In fact, the *only* factor that the authors control for is unemployment rates.

By failing to account for many important factors, or to consider that changes to the bankruptcy code in 2005 coincide with the North Carolina and Georgia ban on payday loans, the authors are unable to show a clear pattern in bankruptcy filings versus payday lending activity. For example, the Georgia data shows a steady increase in bankruptcy filings starting in 1998, with a quick decrease when the new bankruptcy reform takes effect and then a continuing increase after that.

Finally, the data provided by the authors shows that North Carolina residents file for Chapter 7 bankruptcy at rates lower than the national average during periods both with and without payday lending.

Other industry and academic research paints a very different picture, with long-term payday borrowing leading to a high likelihood of default which could spur—rather than prevent—bankruptcy. Rather than a $300 two-week payday loan preventing bankruptcy, borrowers are typically trapped in a debt trap cycle for 18 months or more, with a third to half of all borrowers ultimately ending up in default.[7]

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[1] The Columbia, SC check processing center was closed in August 2004, with checks from that facility then processed at the Charlotte, NC CPC. For more details, see http://www.federalreserve.gov/boarddocs/press/bcreg/2004/200406222/attachment.pdf. The authors note that half of checks processed at the Charlotte CPC are from financial institutions in South Carolina.

[2] In 2005, the Birmingham, AL CPC was closed and checks from this region were processed at the Atlanta CPC. See http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20050208/attachment.pdf. Also in 2005, the New Orleans, LA CPC was shut down and checks once coming into that facility began to be processed at the Atlanta CPC. Finally, in 2007, the Nashville, TN CPC was closed and checks from that region were routed to the Atlanta CPC as well. See http://www.federalreserve.gov/boarddocs/press/bcreg/2005/20051215/attachment.pdf for details on the closing of the New Orleans and Nashville CPCs. These and other consolidations of CPCs across the country have occurred because of the decline of paper check usage.

[3] *North Carolina Consumers After Payday Lending.* Center for Community Capital, November 2007. Available at http://www.ccc.unc.edu/documents/NC_After_Payday.pdf

[4] Pat Cirillo, in testimony to the Ohio House Committee on Financial Institutions, Real Estate and Securities, January 31, 2008.

[5] 1997 is the first year for which the authors provide data. It is unclear whether this trend began in 1997 or in years' prior.

[6] For examples of payday lenders' aggressive collection tactics, see Chris Flores, When Lenders Cross the Line, *Daily Press*, September 16, 2007.

7 In testimony to the Ohio House Committee on Financial Institutions, Real Estate and Securities, January 31, 2008, Pat Cirillo of Cypress Research noted that borrowers tend to remain in payday loans for 18 to 24 months. Using transaction data from one of the largest payday lenders in Texas, Paige Skiba and Jeremy Tobacman estimate default rates on payday loans per borrower. See *Do Payday Loans Cause Bankruptcy?* and *Payday Loans, Uncertainty, and Discounting: Explaining Patterns of Borrowing, Repayment, and Default*. Papers available at http://www.law.vanderbilt.edu/faculty/faculty-personal-sites/paige-skiba/index.aspx.