# Research Comment On: “Payday Loan Rollovers and Consumer Welfare”

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In “Payday Loan Rollovers and Consumer Welfare”, Jennifer Lewis Priestley analyzes proprietary payday loan data for borrowers who received payday loans from 2006-2009 in California, Florida, Kansas, Missouri, Oklahoma, Texas and Utah to estimate the impact of payday rollovers on consumer welfare (as measured by changes in Vantages Score). The author finds that payday borrowers who engage in protracted refinancing or “rollovers” have positive changes to their credit scores, relative to borrowers with shorter periods of payday borrowing. In addition, the author finds that borrowers in states with less restrictive payday loan laws have better credit score outcomes.

*The payday loan industry and CFPB detractors are using the study to argue against the need for meaningful payday loan regulations. However, the study has serious limitations that opponents of payday loan reform do not acknowledge*

### 1) *Methodological Limitations*

- *Omitted Variable Bias*: The study shows a significant relationship between change in credit score and number of rollovers is suggestive of a causal relationship between the two. However, there are likely other variables that are not controlled for that may account for the relationship. For example:
    - *Income/Employment shocks*: Borrowers who lose their jobs may not be approved for subsequent payday loan rollovers and those who suffer from other negative income shocks may default on their loans. Undoubtedly, these same borrowers will likely experience negative changes in their credits scores, compared to borrowers who do not lose their jobs. However, the study does not control for employment status or income of the borrower. As a result of omitting variables that are likely correlated both with the duration of payday borrowing and credit scores, there is a high chance of omitted variable bias.
    - *State-specific economic conditions:* In addition, the study attributes the state fixed effects on credit score changes to differences in state payday regulatory regimes when, in fact, there are many economic factors that could account for these differences (e.g. state unemployment levels, housing markets dynamics such as foreclosures and prices, etc).
- *Misspecification of Regression Models:* According to the study, VantageScore is “is based on multiple general factors regarding a consumer's credit-related behavior, including delinquencies, line utilization, balances, depth of credit,

recent credit and available credit." However, in most of the models, the independent variables indicating bankruptcy, percent of lines over 50% utilized, and balances are not statistically significant, suggesting that the regression is not specified correctly.

### 2) *Negligible Size of Impact*

- Even if methodology weren't limited in the ways outlined above, the magnitude of the impact of rollovers on credit score is miniscule. For every additional rollover, an average borrower achieves an increase of 0.1-0.2 in their scores. Put another way, for every 10 rollovers (at an estimated cost of $450), the average borrower would achieve an increase of 1-2 points in their VantageScore. Given that the average credit score for borrowers in the sample ranged from 579-588[1], the typical payday borrower would need an increase of 13-22 points just to move from the highest risk "F" category to the next highest risk "Non-Prime" category.[2] Therefore, any claim that sustained use of payday loans has a positive impact on consumer's welfare is hard to support by any reasonable cost-benefit analysis.

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[1] See Table 5.

[2] See Irby, Latoya. "VantageScore Credit Overview", available at http://credit.about.com/od/vantagescore/a/vantage-score-overview.htm