More on the Pew Payday Loan Study

The Report arrives at four "Key Findings" and uses these Findings to attack the payday lending industry. According to the Report:

1. Twelve million American adults use payday loans annually. On average, a borrower takes out eight loans of $375 each per year and spends $520 on interest.

2. Most borrowers use payday loans to cover ordinary living expenses over the course of months, not unexpected emergencies over the course of weeks. The average borrower is indebted about five months of the year.

3. If faced with a cash shortfall and payday loans were unavailable, 81 percent of borrowers say they would cut back on expenses. Many also would delay paying some bills, rely on friends and family, or sell personal possessions.

4. In states that enact strong legal protections, the result is a large net decrease in payday loan usage; borrowers are not driven to seek payday loans online or from other sources.

The Report has significant global weaknesses and flaws. It is based on surveys of only 450 storefront borrowers (and far fewer online borrowers) who were asked about their transactions up to five years in the past. With its unmistakable hostility to payday lending, Pew assumes, without real proof, that payday borrowers are induced to take loans by lender misrepresentations and/or the borrowers' own cognitive foibles. However, Pew ignores that payday loans are one of the simplest loan products available and that payday borrowers repeatedly report that they understand how their loans work.

Further, the Report does not acknowledge the real and substantial economic benefits payday loans provide nor, therefore, does it begin to assess the role these benefits play in the remarkable popularity of payday loans. Because it focuses solely on supposed problems with payday loans, while ignoring the other side of the equation, the Report sheds no real light on the net impact of payday lending on consumer financial health. For example, in a statistic picked up by *The New York Times,* Pew says in the Report that 27% of borrowers reported that payday loans caused them to overdraft their checking accounts. This finding is interesting at some level but the function of payday loans in helping consumers **avoid** overdrafts is well-known. One wonders: How many (and what percent of) borrowers **avoided** bank overdraft charges by obtaining payday loans? Undoubtedly because the answer to this question would undercut the Report's overall thesis, Pew does not ask and the Report does not say.

The individual Findings and related conclusions are also problematic. Starting with the Introduction and continuing through Finding 1 and the remainder of the Report, Pew castigates payday lenders for selling or promoting payday loans as short-term financial solutions when the Report (mis)construes available statistics to claim that the "average" payday borrower renews the initial loan for four to five months over a period of approximately 145 days. This claim is based on duration information reported by the country's largest payday lender (showing that the average loan is approximately 18 days) and statistics compiled by regulatory authorities (suggesting that, on average, payday borrowers obtain eight loans **in a year**). Pew grievously

errs by confounding **annual** utilization numbers with the average length of a **single loan**, after renewal. And the *New York Times* takes this error a step further when, immediately before citing the Pew "data," it states that payday loans are structured in a way that "inevitably" turns a short-term obligation into long-term debt. Of course, a payday borrower who uses the product eight separate times during a year, as needed, presents an entirely different picture than a borrower who renews a single loan seven times in succession. There is nothing "inevitabl[e]" at all about repeated renewals of payday loans and no support in the Pew study for a claim that renewals are inevitable. Further, the Report blames payday lenders for misrepresenting payday loans as short-term solutions to financial problems when the statements in question are frequently required by state law and, when fairly read, constitute admonitions that, if possible, the loans **should** be used over short periods and are not misleading claims of how the loans are typically used.

Regarding Finding 2, Pew seems to accept without question that payday loans are problematic if their primary function is to help borrowers cope with day-to-day living expenses rather than emergency expenditures. In this respect, it implicitly assumes that borrowers are capable of reducing their monthly expenses or that the availability of payday loans **causes** (rather than redresses) a lack of discipline that gets borrowers into trouble. I doubt that either of these assumptions is correct (especially the latter assumption that the availability of payday loans leads to increased expenditures).

Further, Pew views 16% utilization of first-time payday loans for emergency expenditures and 69% first time use for recurring expenses as problematic for payday lending. However, the recurring expenses category is defined to include rent/mortgage, food, utilities, car payments and credit card payments. Moreover, only 8% of initial payday loans were due to "something special" or "other." Thus, fully 85% of initial loans seem attributable to essential expenditures—a finding I regard as **supportive** of payday lending. Pew's unexamined position that the only legitimate use of payday loans is for emergency expenditure is both value-laden and paternalistic.

In Finding 3, Pew accepts at face value the claim by 81% of borrowers that, if they were faced with a cash shortfall and had no access to payday loans, they would cut back on expenses, and the further claim that they would delay paying bills, rely on family and friends or sell possessions. There are numerous problems with this "finding," including the following:

- While borrowers might well take (or try to take) all of the enumerated actions when faced with a funding problem of this type, Pew never asks whether any or all of these steps would be successful. Does Pew really believe, as reported, that 44% of borrowers could (successfully) obtain a loan from a bank or credit union, that 37% could simply use a credit card and/or that 17% could borrow from an employer? And are family and friends really able and willing to help the payday loan borrower?

- Pew left off the list of potential actions two of the obvious steps a consumer might take if payday loans were not available in storefronts in the consumer's state: (1) seek a loan at a storefront in a neighboring state; or (2) seek a loan online. Why were these options not presented to surveyed consumers?

- Pew also failed to ask why a consumer with all of the other options Pew listed (and clearly views as superior to a payday loan) obtained a payday loan in the first place. If Pew had asked this question, it might have discovered that there were good economic reasons for the choice of a payday loan and an explanation other than consumer ignorance or lender deception.

- Pew assumes that simply delaying the payment of bills is a good alternative to a payday loan. Certainly, a consumer who has run out of cash and cannot borrow must necessarily spend less. But that is not a palatable alternative if it means the consumer does not have money for food, housing payments or other essentials. Deferring payments risk a loss of housing or essential services, as well as late fees and disconnection charges.

In short, Pew seems oblivious to the difference between a person **saying** he or she will do something in a hypothetical situation and actually **doing** it in real life. Certainly, the individuals in question all believed at the time that a payday loan was the best option available to them. The answers to this survey question do not call this real-world decision into doubt.

Finally, as to Finding 4, the Report claims that 95% of would-be borrowers in states that prohibit payday loans never go online and that online lending is only slightly more prevalent in states with restrictive laws than in liberal states. In the face of recent trends showing marked growth of online lending, steady decline of storefront lending and tougher regulation, I simply do not believe these counter-intuitive findings. As noted above, Pew could have directly asked borrowers—but chose not to do so for some unexplained reason—whether they would substitute online borrowing if they encountered a need for funds and storefront loans were not available. Moreover, its findings are based solely on survey data that is necessarily open to question. Indeed, the Report itself acknowledges (in a footnote) three separate studies that all found evidence of payday loan borrowers falsely denying their usage of these loans in surveys. Additionally, the finding of a lack of substitution of online loans for storefront loans is directly undercut by a separate finding outlined in the Report, namely that payday loan complaints are roughly the same, as a percentage of the population, in liberal and restrictive states. If this latter finding is correct and consumers are not replacing storefront loans with online loans, where are the complaints coming from in restrictive states?