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# Do state regulations affect payday lender concentration?

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ABSTRACT

Ten states and the District of Columbia prohibit payday loan stores, and thirty-one other states have imposed regulatory restraints on their operations, ranging from limits on fees and loan amounts to the number of rollovers and renewals allowed a borrower. Given the importance of payday lenders to significant segments of the population and the wide variation among state regulatory regimes, our paper examines the extent to which the concentration of payday lenders in counties throughout the country is related to the regulatory environment as well as to various financial and demographic factors. The analysis is based on a unique dataset that has been obtained directly from each state's appropriate regulatory authority.



## 1. Introduction

Payday loans are among the easiest small loans to obtain. A borrower typically needs only a checking account and documentation of a steady source of income, either from a job or other verifiable source. The loans are extremely short term, typically structured with a due date that coincides with the borrower's next payday, usually within two weeks. A borrower provides the lender, known as

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a payday lender,[1] with either a postdated personal check for the loan amount and lending fee, or the authorization to electronically debit the checking account for the amount due. When the loan is due, the lender deposits the personal check or initiates an electronic withdrawal from the borrower's checking account.

Payday loans differ from bank loans because the borrower is charged a single flat fee, such as $15 per $100 borrowed, rather than recurring interest payments. This practice is allowed even though the flat fees, when converted to interest rates, almost always exceed state usury rates. For this reason and others, however, the payday lending industry has generated much debate, especially in recent years, over its practices and customer base. Amid allegations that payday loans are not only usurious but predatory, payday lenders face varying operational restrictions in states, even being prohibited in some of them.

The controversy over payday lenders centers on the fees they charge and their typical customer base. Consider the fees on payday loans in the following two states. In Indiana the allowable fee of $15 for a $100 loan on a fourteen-day payday loan is equivalent to an annual percentage rate of 390 percent. However, in Missouri the allowable fee of $75 for the same size loan translates into an annual percentage rate of 1950 percent.[2] Certain consumer organizations, advocacy groups, and state attorneys general consider such high interest rates to be outrageous and downright inappropriate, a factor no doubt in the decision by some state governments either to ban payday lending stores or to impose much lower interest rate caps on their loans. In addition, payday lenders are often subjected to accusations that they engage in predatory lending by locating their stores in areas with higher concentrations of low-income individuals, who are unemployed, less educated, and disproportionately African American and Hispanic. Indeed, Ohio Senator Sherrod Brown voiced the concern during a 2014 hearing of the Senate Banking Committee "that payday companies are marketing their high-cost loans to the very people who can least afford them, much like predatory mortgage lenders did in the run up to the housing crisis."[3]

Our paper examines the relationship between the different regulatory restrictions imposed on payday lenders and the concentration of their stores throughout the United States. The examination is based on both county- and state-level data. The latter data enables us to capture differences in the regulatory environment that constrains the prices and other aspects of the loan products that payday lenders may offer. The county-level data when combined with the state-level data enable us to conduct an empirical analysis to determine the extent to which the numbers of payday loan stores correlates to state regulatory restrictions, as well as to the various demographic and economic characteristics of the neighborhoods in which they are located.[4] Based on a new and unique dataset obtained directly from each state regulatory authority, we find that payday lenders operate more stores in those counties located in states whose regulatory regimes are more lenient.

The remainder of the paper proceeds as follows. Section 2 provides a selective literature review. This is followed by an overview of the payday lending industry. Section 4 discusses the problem of obtaining data on the operation of payday lending firms throughout the nation and information on

[1] Payday lenders are also referred to as deferred deposit originators, and their product as payday advances, cash advances, deferred deposits, among other terms. While overdraft credit provided by banks is related to payday credit, Morgan et al. (2012) report that payday loans are typically cheaper than covered overdrafts.

[2] The interest rates in both cases are calculated assuming that both loans are outstanding for a year and the fees are paid every fourteen days. Of course, the rates are much higher if one assumes a new loan is taken out every fourteen days and the same fees are charged.

[3] See Douglas (2014, p. 2).

[4] Due to limited availability of data, the paper focuses on actual storefronts to the exclusion of online payday lenders. However, William H. Sorrell (2014, p. 1), attorney general of Vermont, recently stated that "Online lenders nationwide (currently numbered at over 200) earned over $18 billion dollars in income from high-interest, small-dollar loans made in 2012." Yet, according to the CFPB (2013), these online payday loans still make up a minority of the total loan volume, and the loans are offered with fees equal to or higher than storefront loans. In Appendix 1 we provide information on both in-state and online payday lenders. As the appendix shows, online payday lenders only account for 6.2 percent of all payday lenders. It should be noted that in the late 1990s some payday lenders began partnering with nationally chartered banks and that payday loans became "bank loans" because such banks were not subject to state-imposed fee caps or usury laws. However, the Federal Deposit Insurance Corporation took actions in 2003 and 2005 that, according to Stegman (2007, p. 179), "rendered the rent-a-bank model obsolete."