

# Keeping Texas Competitive

## A Legislator's Guide to the Issues 2013-2014



### Short-term Consumer Lending

#### The Issue

In the wake of the 2008 financial crisis, lenders and consumers alike have had many concerns regarding the state of the credit market. Traditional banks have tightened restrictions on lending, making it more difficult to obtain credit, especially when the need arises very suddenly and unexpectedly.

For consumers who don't meet banks' lending criteria, options are limited, especially when the necessary funds are too "small" for the bank, and when borrowers don't have proper credit ratings and can't obtain credit cards. One option for these individuals is payday lending, especially after being rejected by a traditional bank. Contrary to popular opinion, the individuals seeking such lending are not undereducated or unemployed; rather, they are normal individuals who needed a short-term loan to tie them over after an unexpected expense. Often, these individuals are renters, and thus aren't able to use home equity to help them cover their needs.

Oftentimes, credit service organizations (CSOs) will help loan-seekers locate third-party lenders for a fee; the lenders in turn deposit money in an individual's account against a future paycheck. However, these fees, and payday lending in general, are often targeted by governments. In the last session, no fewer than 18 bills targeted the practice, including ones that would institute restrictions on charging fees.

The bills in question would have likely driven many payday lenders out of the business, as happened when New Hampshire created new regulations. Rather than protecting consumers, it likely would have dried up their last attempts at credit, making it more difficult for those with sudden needs from meeting those needs, often at great personal cost. Fortunately, only two of the 18 bills passed, and they were the least restrictive and harmful to the market (one requiring a posting of rates in store-fronts, and one requiring fee payment and registration by lenders with the Consumer Finance Commissioner). However, new regulations are bound to harm the market, and are unnecessary; consumers are able to make their own decisions as to whether the fees and costs are worth the utility of the loan. Calls for regulation also incorrectly assume that CSOs are unregulated, which is simply not true.

Those who need access to credit already face a hard challenge. New regulations of the market would make that challenge even more difficult, and in some cases could make it impossible. On the other hand, consumers benefit when they are able to secure credit in a timely fashion. Keeping short-term lenders open extends credit to all those who need it.

#### The Facts

- An estimated 40% of payday loan recipients seek such loans only after rejection by traditional lenders.
- Payday borrowers, contrary to popular belief, are educated and employed.
- Regulations in other states have forced many such lenders out of business, limiting credit options for those that the laws supposedly were designed to protect.

### Recommendation

- No attempts should be made to add further barriers to payday lending and restrict access to capital for those in need of short-term loans.

### Resources

*Consumer Benefits of Access to Short-Term Credit* by Ryan Brannan, Texas Public Policy Foundation (Mar. 2011).

*Evaluating Consumer Access to Short-Term Lending* by Ryan Brannan, Texas Public Policy Foundation (Apr. 2011).

*Center for Economic Freedom: Review of the 82nd Session of the Texas Legislature* by Bill Peacock and Ryan Brannan, Texas Public Policy Foundation (June 2011).

