2019-20

LEGISLATOR'S GUIDE to the Issues

Short-Term Consumer Lending

The Issue

In the wake of the 2008 financial crisis, lenders and consumers alike have had 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 do not meet banks' lending criteria, options are limited, especially when the necessary funds are too "small" for the bank, and when borrowers do not have proper credit ratings and cannot obtain credit cards. One option for these individuals is payday lending.

Contrary to popular opinion, the individuals seeking such lending are not undereducated or unemployed; rather, they are normal people who need a short-term loan to cover unexpected expenses.

Credit service organizations (CSOs) will often help loan-seekers locate third-party lenders for a fee; the lenders then deposit money in an individual's account against a future paycheck. However, these fees, and payday lending in general, are often targeted by governments. Each session, multiple bills target the practice, including some that would place restrictions on charging fees.

These types of bills would have likely driven many payday lenders out of the business, as happened when New Hampshire created new regulations. Rather than protecting consumers, these actions could have dried up consumers' credit options, preventing them from meeting sudden needs, often at great personal cost.

Fortunately, no major regulatory bill has passed in recent sessions. However, more than 40 Texas cities have adopted strong local payday and auto title ordinances restricting these short-term consumer lending practices. Advocates have pledged to encourage more communities to do the same. 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 value of the loan. Calls for regulation also incorrectly assume that CSOs are unregulated, which is not true.

Those who need access to credit already face a challenge. New regulations of the market would make that challenge more difficult, and possibly 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 opportunities 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 the laws were supposedly designed to protect.
- More than 40 Texas cities have adopted ordinances that restrict payday lending and title loans, creating a patchwork of inconsistent financial regulation throughout the state.

Recommendation

No attempts should be made to add further barriers to payday lending.

Resources

"Restrictions on Payday Lenders Cost Texas Jobs" by Bill Peacock, Dallas Morning News (Dec. 2, 2015).

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

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

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