

CRL Critique of “Payday Holiday: How Households Fare After Payday Credit Bans” by Donald P. Morgan and Michael R. Strain, November 2007

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In a recent working paper, Donald Morgan, a researcher affiliated with the New York Federal Reserve and Michael Strain, a Cornell University graduate student, attempt to determine whether households in two states which have outlawed payday lending (North Carolina and Georgia) have fared better than households in states in which payday lending is still authorized. The authors analyze patterns of returned (bounced) checks, complaints filed with the Federal Trade Commission (FTC) against lenders and debt collectors, and federal bankruptcy filings, and conclude that “Georgians and North Carolinians do not seem better off since their states outlawed payday credit.”

The authors base this conclusion on their findings that Georgia and North Carolina residents (1) had greater rates of returned checks than the national average; (2) complained more to the FTC about lenders and debt collectors; and (3) filed for Chapter 7 bankruptcy at rates greater than the national average.

However, Morgan and Strain’s data and research methods are not adequate to support these findings or overall conclusion. The primary flaws are discussed briefly here:

1. Overall, when the authors compare the “credit problems” for households in Georgia and North Carolina to the national average for households in the United States, they fail to note that the national averages include, during the time period reviewed, at least ten states (with one-quarter of the U.S. population) that—like North Carolina and Georgia—do not authorize payday lending. This confusion of “payday versus non-payday” states was also exhibited in previous research by Morgan.¹
2. In analyzing returned checks, the authors use data from the Federal Reserve’s *regional* check processing centers (CPCs) as proxies for *state* credit markets. However, the regional CPCs in Atlanta and Charlotte handle checks for other states besides Georgia or North Carolina, including states that allow payday lending. For example, more than half of the checks processed at the Charlotte center come from states which allow payday loans. Similarly, during the aftermath of Hurricane Katrina, checks from households in Louisiana (which also allows payday lending) began to be processed in the Atlanta center. Because the CPC data includes returned checks for states that authorize payday lending, it is incorrect to use this data as representative of “non-authorizing” states like Georgia and North Carolina.

This data simply shows that people living in the *regions* covered by the Atlanta and Charlotte CPCs tend to have a higher rate of returned checks than those living in other regions of the country. However, this higher rate is minuscule—in Atlanta’s worst quarter after the payday ban, they had two-tenths of one percent more returned checks than the national average. In other quarters, they were actually below the national average. Charlotte’s CPC has had fairly consistent above national average rates ranging from 0-0.4% throughout the study period, *before, during, and after* payday lending was legal in North Carolina.

Finally, the authors erroneously assume that bounced checks are the *only* substitute for a payday loan: "Of course, households in Georgia and North Carolina had only one choice once payday credit was banned. If we observe higher bounced checks afterwards, it tells us payday credit was the preferred choice..." But a recent study by the University of North Carolina Center for Community Capital found that former payday borrowers use a host of options to cover financial shortfalls, such as working out delayed payments with creditors; borrowing from family, friends, or employers; dipping into savings; or delaying a purchase for a short period of time.²

3. In analyzing complaints to the FTC, the authors find that people in Georgia complain more to the FTC than those in other states. However, this was the case before and after the payday lending was halted in 2004, with a steady upward trend beginning in at least 1997 (the first time period for which the authors provide data.) Second, as Morgan finds Georgia has the second highest rate per capita of FTC complaints per year, they note that the jurisdiction with the highest complaint rate was the District of Columbia. Yet during the time period for this research, the District of Columbia had some of the loosest restrictions on payday loans of any state. This appears to refute the authors’ attempt to develop a cause-effect relationship between the absence of payday lending and FTC complaints. Moreover, the authors admit that the rate of FTC complaints from households in North Carolina is *not* higher than complaint rates in other states.

The data does show a steady *national* increase in FTC complaints for some time but especially since 2001. Many experts have attributed this to rise of identity theft; this is confirmed by the FTC as over 40 percent of all complaints involve challenging the actual validity of the debt. We are not aware of even a potentially plausible relationship between payday lending and ID theft.

The number of complaints logged by the FTC also is affected by what sorts of financial services state residents were using. For example, a consumer wishing to complain about high credit card fees would log their complaint with the FTC. However, a person wishing to complain about a 391% APR payday loan and payday lender debt collection tactics would be directed to their state regulator, as the FTC has no standing in this area.

4. In analyzing variances in bankruptcy rates among states, the authors fail to account for several factors which greatly influence a person's chances of filing for bankruptcy protection. These factors include health insurance coverage, mortgage foreclosures, divorce rates, demographic factors such as income, and broader economic factors. Yet the *only* factor which the authors control for is unemployment rates.

By failing to account for many important factors, or to consider that changes to the bankruptcy code in 2005 coincide with the North Carolina and Georgia ban on payday loans, the authors are unable to show a clear pattern in bankruptcy filings versus payday lending activity. For example, the Georgia data shows a steady increase in bankruptcy filings starting in 1998, with a quick decrease when the new bankruptcy reform takes effect and then a continuing increase after that. North Carolina residents file for Chapter 7 bankruptcy at rates lower than the national average during periods both with and without payday lending.

¹ Morgan, Donald. [Defining and Detecting Predatory Lending](#). *Federal Reserve Bank of New York Staff Reports*, Number 273, January 2007. Available at http://www.newyorkfed.org/research/staff_reports/sr273.html. CRL's critique of this study, demonstrating the "confusion" between payday and non-payday states, is available at <http://www.responsiblelending.org/pdfs/Review-of-Morgan-paper.pdf>

² *North Carolina Consumers After Payday Lending*. Center for Community Capital, November 2007. Available at http://www.ccc.unc.edu/documents/NC_After_Payday.pdf