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# Payday Loan Choices and Consequences

**This research does not necessarily represent the views of  
the Federal Reserve**

# Data: Merge payday loan applicant and credit history data

- PDL applicant data from one major lender
  - Focus on first-ever application
  - Applications span 2001-2004
- Match applicants to their credit records
  - FRBNY/Equifax Consumer Credit Panel
  - Snapshot every quarter, 1999:1 – 2010:1
  - Match rate ~98%;
  - At time of application, ~97% have credit score and ~86% have  $\geq 1$  account

# Research Questions

- **Who uses payday loans and why?** (e.g. Elliehausen and Lawrence 2001; Pew 2012)
- **Are payday loans beneficial? harmful?** (e.g. Morse 2011; Zinman 2010; Melzer 2011; Skiba and Tobacman 2011)

# Circumstances at time of PDL application

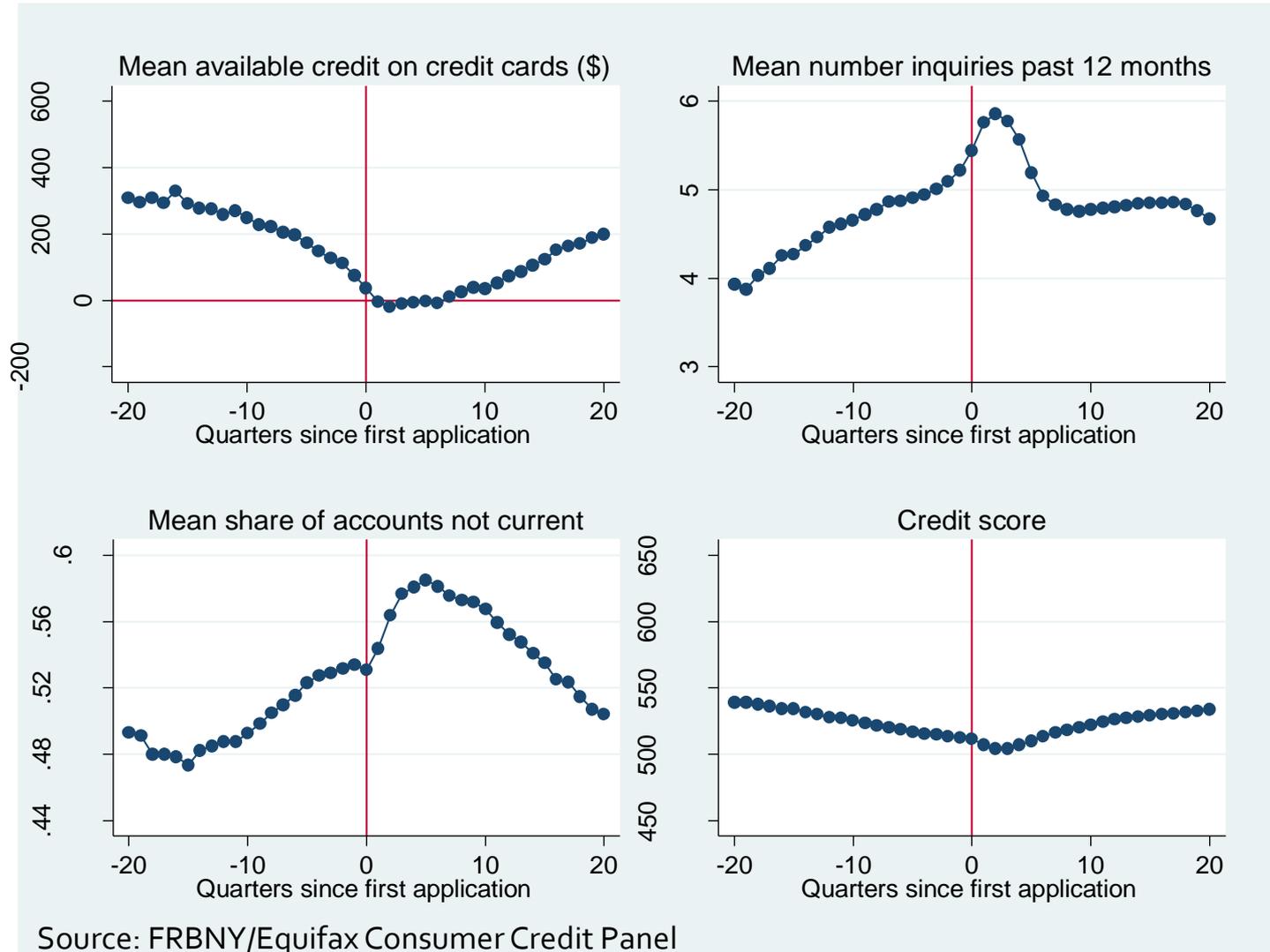
	PDL Applicants (N=38,220)	Gen Pop (2002:4) (N=103,766)
Median number of open accounts	3	4
Median debt balance	5977	9120
Median share of accounts not current	50%	0%
Share with at least one credit card	59%	75%
Median cardholder balance (all cards)	\$1,340	\$1,586
Median cardholder limit (all cards)	\$1,154	\$11,000
Cardholders with delinquent card account	69%	16%
Share with an auto loan	39%	28%
Median auto balance	\$11,121	\$12,456
Borrowers with delinquent auto account	35%	9%
Median number of inquiries in past 12 months	4	1
Median number of new accounts in past 12 months	1	1
Median Equifax credit score (range: 280-850)	517	702

Source: FRBNY/Equifax Consumer Credit Panel

# PDL applicants clearly in bad financial shape

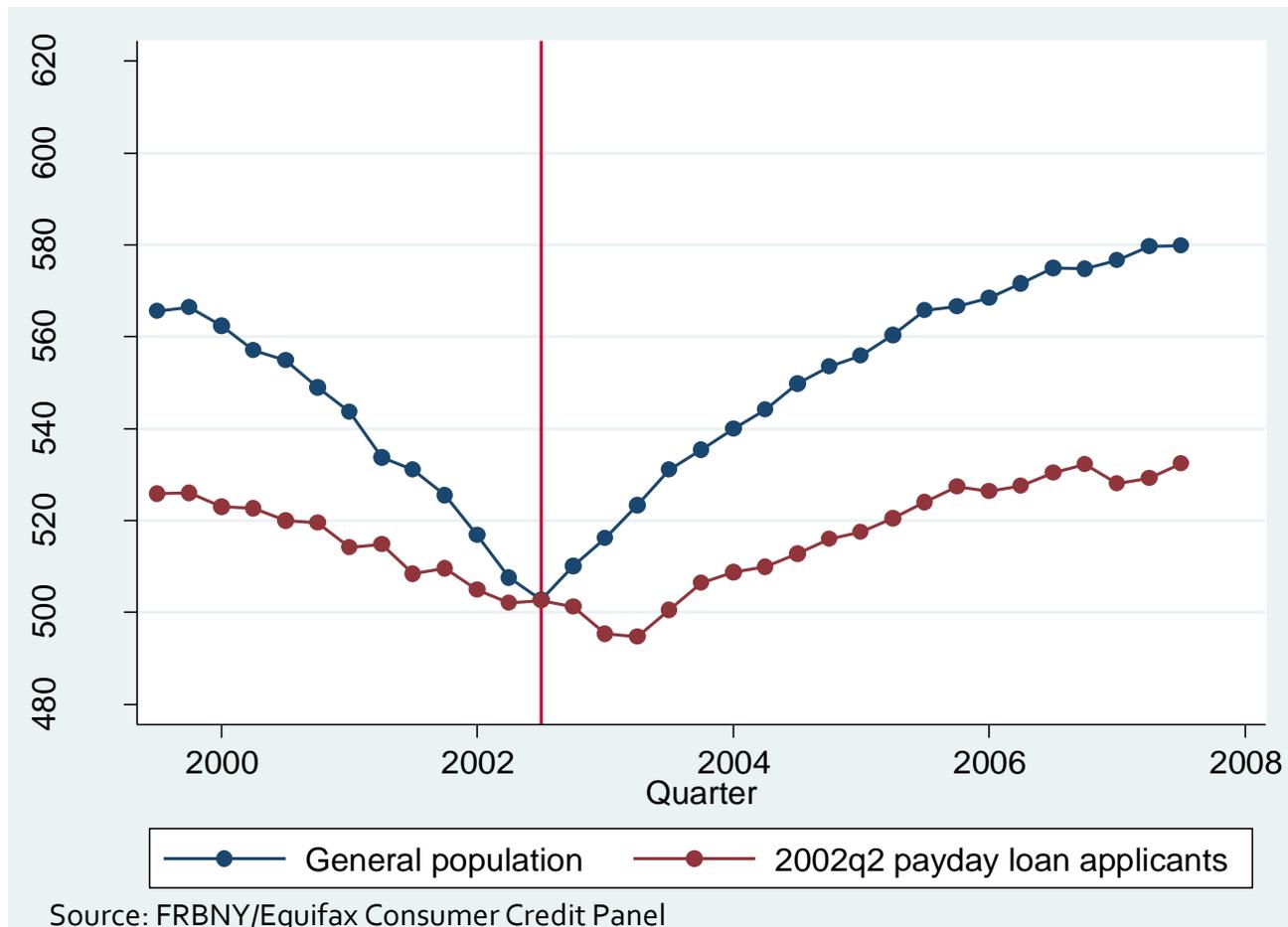
- Major cash flow shortfall
- Searching for more credit
- Result of a recent financial shock? ....

# No... applicants appear to be in bad shape even many years ago



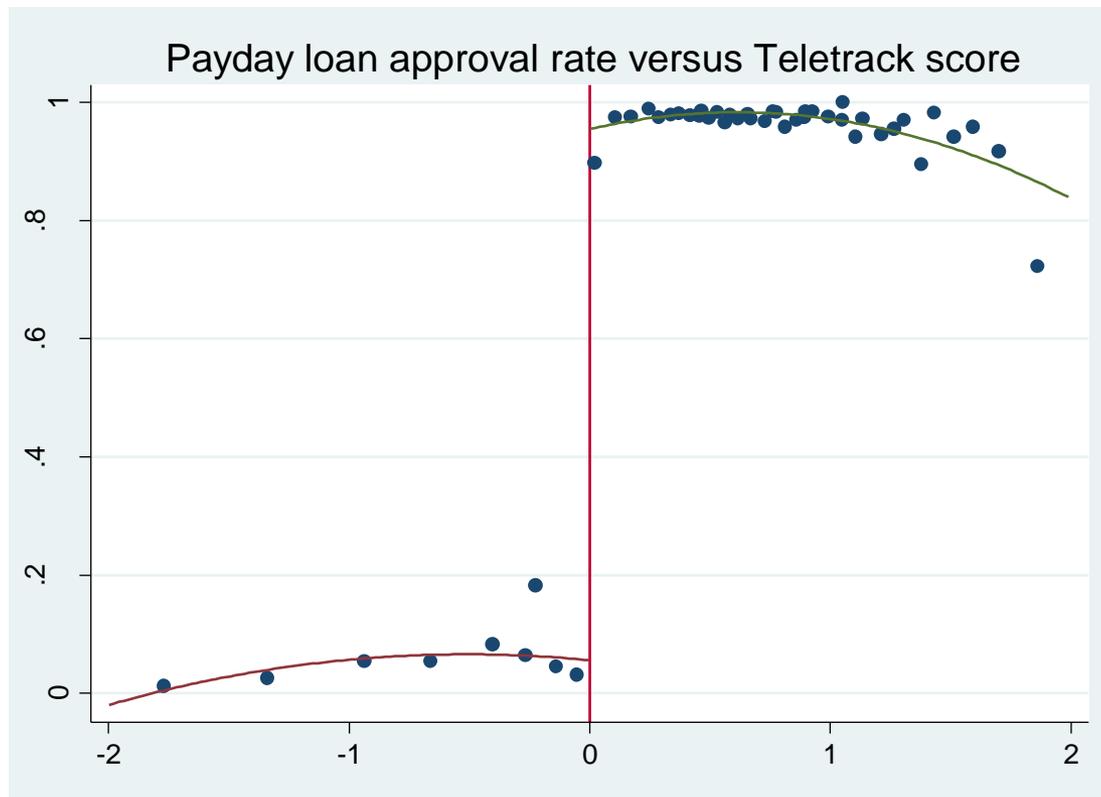
# Payday applicants' low credit scores are unusually persistent

- Applicants in 2002:2 vs. random sample of consumers with the same scores at time of application

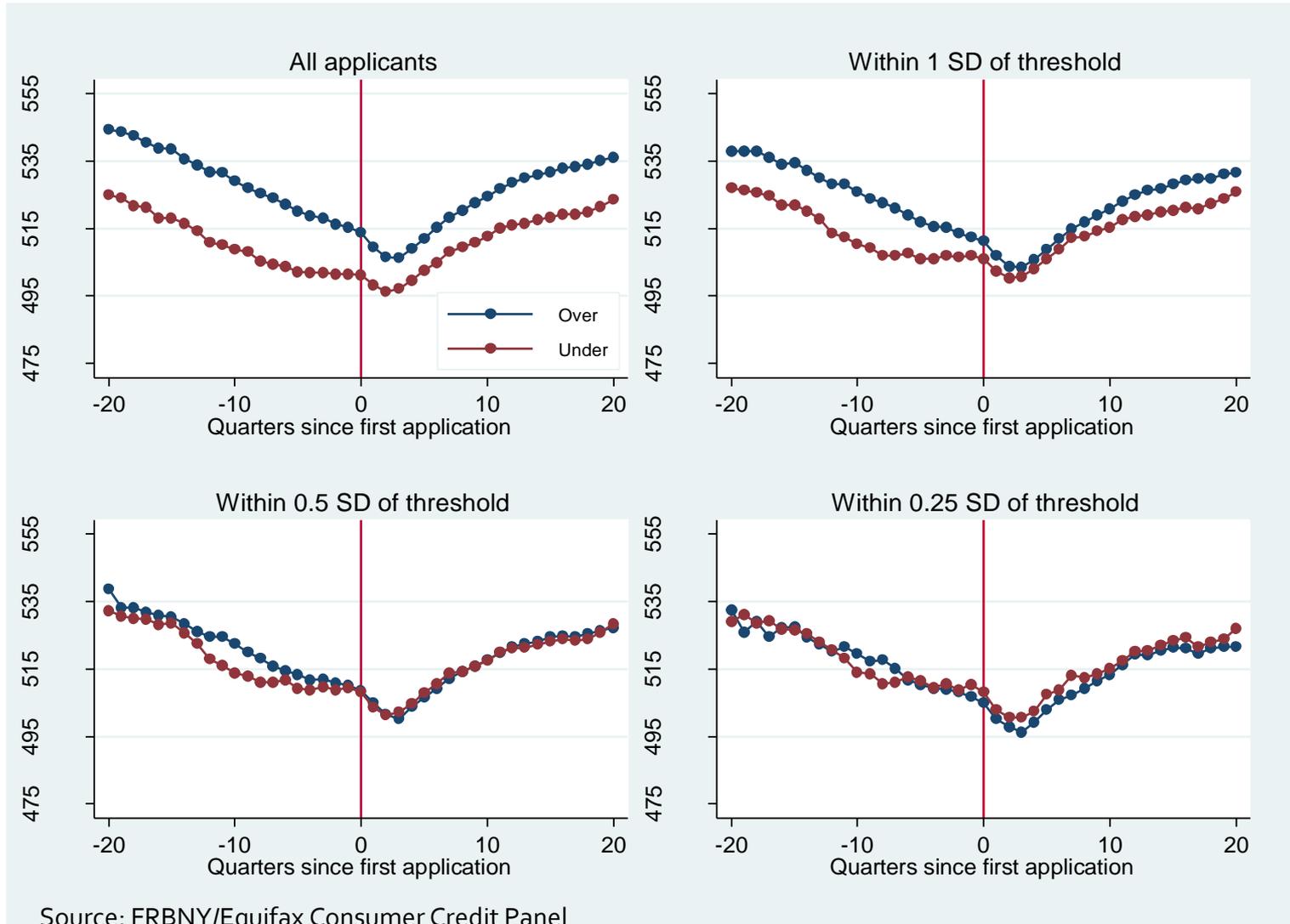


# Does getting a payday loan help/hurt credit scores?

- Teletrack score determines payday loan approval
- Compare applicants just above/below approval threshold
- **Note: payday loans don't *directly* affect credit scores**

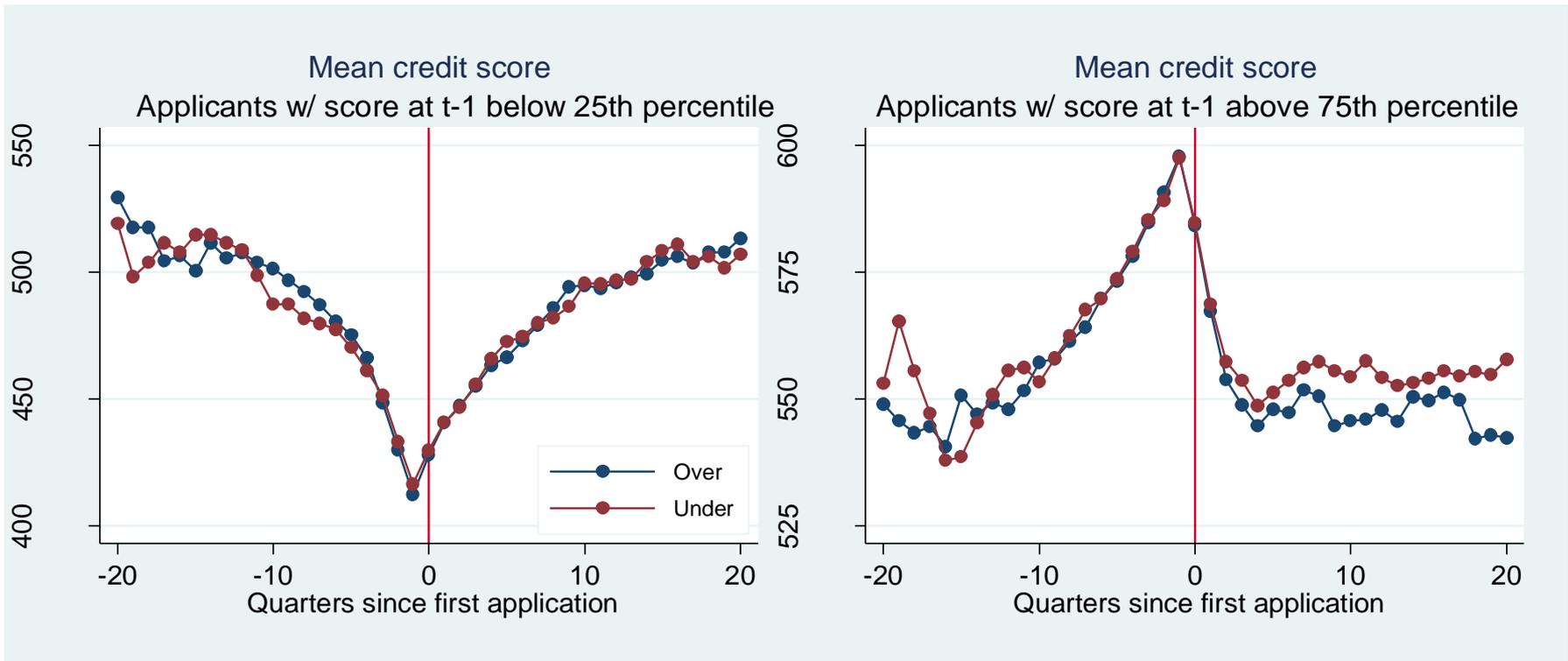


# Credit scores of approved vs. denied applicants over time



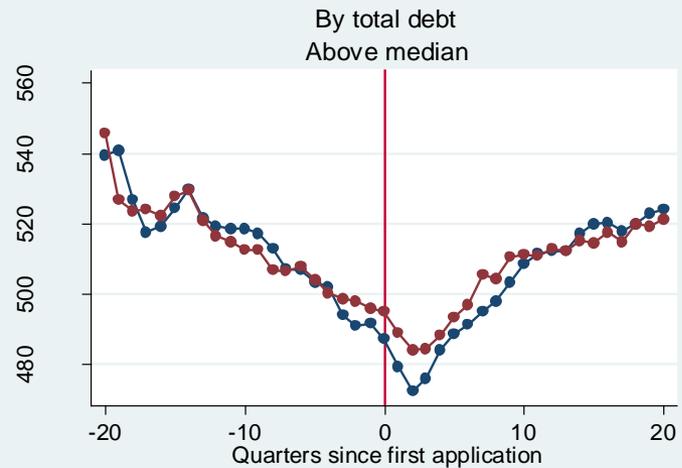
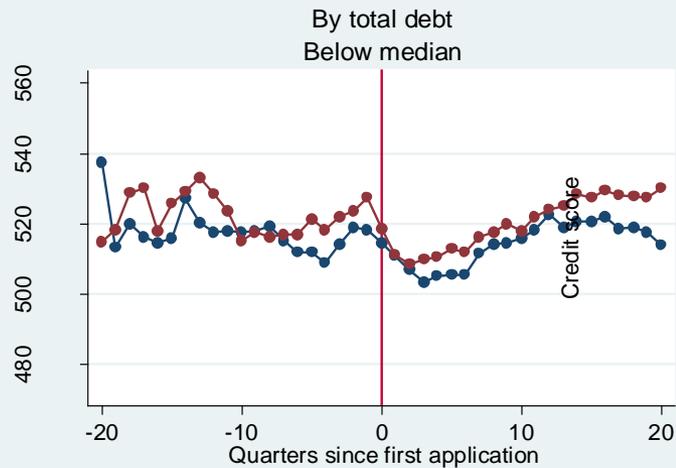
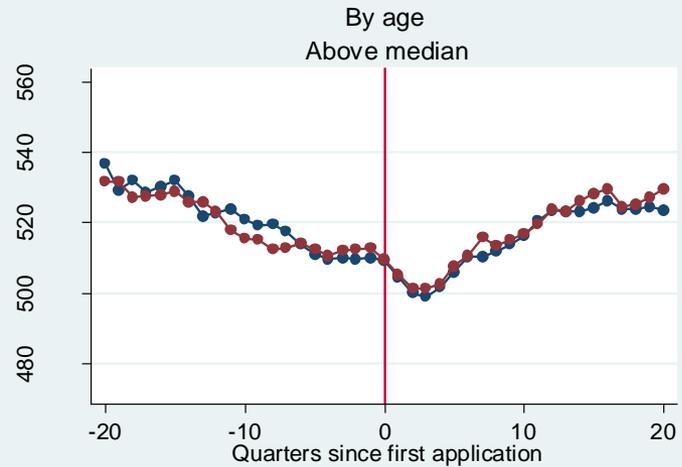
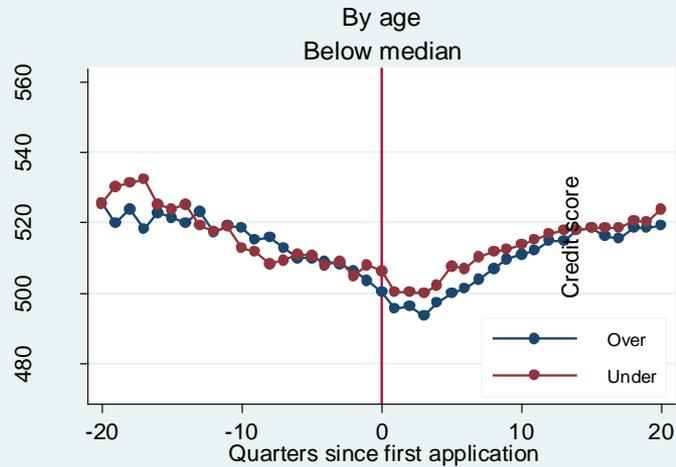
# Heterogeneous effects?

- Effect of getting a payday loan for those in the top/bottom quartile of the applicant credit score distribution



Source: FRBNY/Equifax Consumer Credit Panel

# Heterogeneous effects? (cont.)



# Issue: we only observe applications at one lender

- Just-rejected applicants are far less likely to apply again; may be hesitant to apply elsewhere too
- Similar results in places with lack of alternative PDL companies
- Bhutta (2012) compares “likely” PDL borrowers in states that allow loans vs. states that ban loans
  - Thus far, no evidence that access affects credit scores or score dynamics

# Conclusions

- PDLs used as last resort
  - Credit card lines are exhausted
  - Intense search for cheaper credit is unsuccessful
  - Extremely high delinquency rate
- PDL applicants persistently in financial distress
  - Do PDLs mainly attract those who have trouble committing to a budget?
- No evidence that payday loans affect credit scores