

**PROHIBITIONS, PRICE CAPS, AND DISCLOSURES:
A LOOK AT STATE POLICIES AND ALTERNATIVE
FINANCIAL PRODUCT USE**

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ALTERNATIVE FINANCIAL SERVICE (AFS) PRODUCTS

- ◆ **Auto title loan:** small loan secured by a borrower's vehicle
- ◆ **Payday loan:** small loan secured by a borrower's next paycheck
- ◆ **Pawnshop loan:** small loan secured by a borrower's property
- ◆ **Refund anticipation loan (RAL):** loan secured by a taxpayer's anticipated income tax refund
- ◆ **Rent-to-own transaction:** self-renewing weekly or monthly lease for merchandise (e.g., furniture) with the option to purchase

RESEARCH QUESTIONS

1. What is the relationship between state-level alternative financial service (AFS) policies and AFS use?
2. Are restrictions on one AFS product associated with increased use of other AFS products?

LITERATURE ON AFS PRODUCTS

- Some AFS suppliers circumvent state laws
- Binding price caps and prohibitions are likely to reduce supply
- AFS consumers have relatively few alternatives
- Consumers are not necessarily better off without AFS products
- Well designed and timed disclosures can affect consumer behavior
- Fee disclosures may be better than APR disclosures on AFS products

HOW MIGHT STATE POLICIES AFFECT AFS USE

- State policies can affect both the supply of and the demand for AFS products and thus consumer use of the products.
- The state policies we examine fall into three categories: prohibitions, price caps, and disclosures.
- Overall, we expect prohibitions decrease consumer use, price caps either increase or decrease use, and disclosures decrease use.

STATE AFS POLICIES

	Number of States
Auto Title Loan	
Product Prohibited	26
APR price cap	12
Payday Loan	
Product Prohibited	13
APR price cap	33
Pawnshop Loan	
Monthly interest rate price cap	40
Return requirement	10
Refund Anticipation Loan	
Disclosure requirement	14
Rent-to-Own	
Price or APR cap	11
Total cost label disclosures	16
Contract disclosures	47

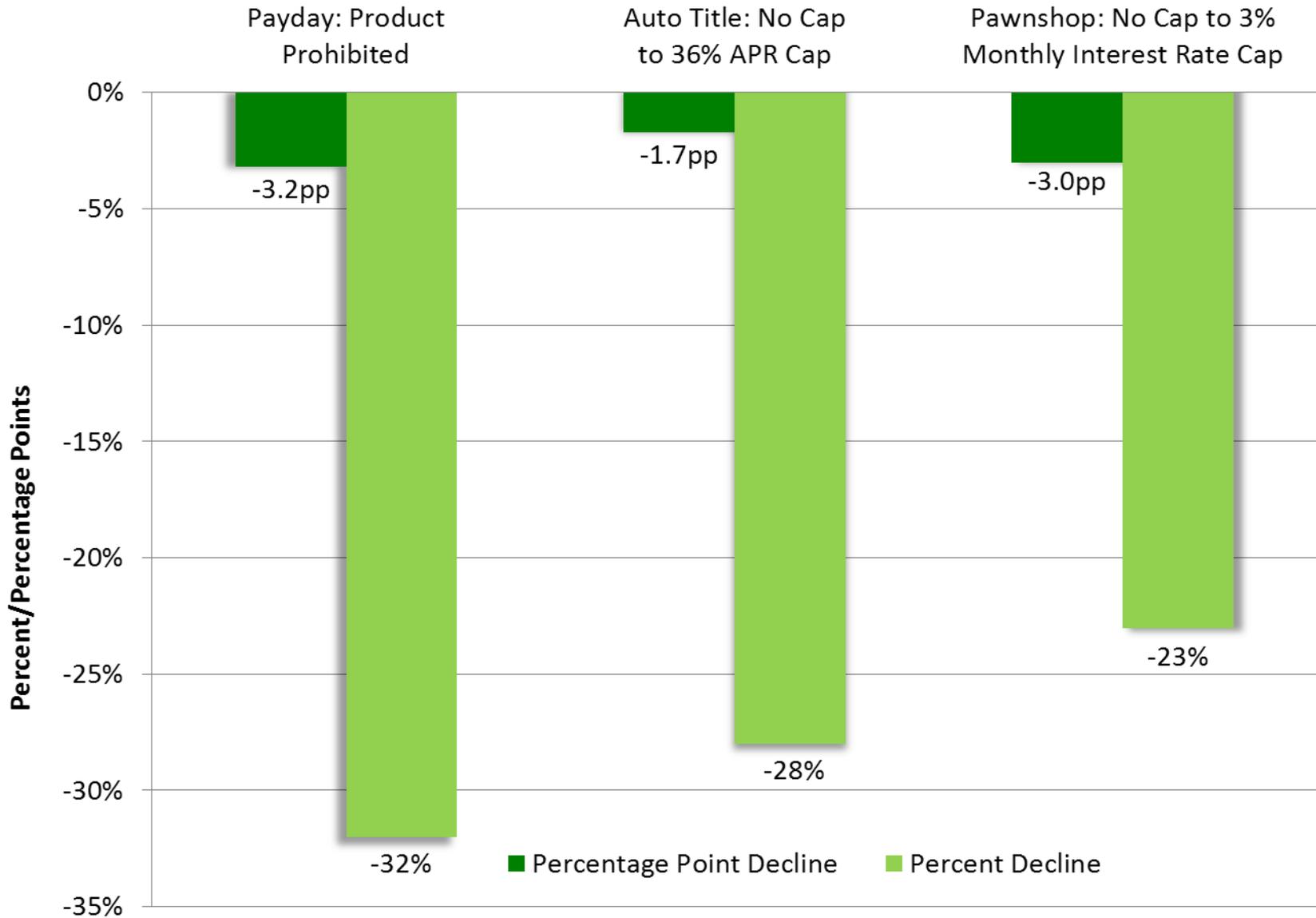
DATA AND APPROACH

- ◆ 2009 National Financial Capability State-by-State Survey
- ◆ Point-in-time information about respondents' demographic and financial characteristics
 - ◆ Age, educational attainment, financial literacy, race/ethnicity, gender, living arrangement, number of financially dependent children, income, banked status, presence of car insurance, region.
- ◆ Use of AFS products over the last five years
 - ◆ Auto title, payday, pawnshop, RALs, and rent-to-own
- ◆ Estimate separate regression models for each product
 - ◆ Own policies
 - ◆ Own policies plus policies of other AFS products

WHAT IS THE RELATIONSHIP BETWEEN AFS POLICIES AND AFS USE?

- ◆ More stringent price caps and prohibitions are associated with lower AFS product use
 - ◆ Payday, auto title, pawnshop loans, and rent-to-own
 - ◆ Suggests that supply falls as price is restricted
- ◆ No evidence that disclosure requirements are associated with lower AFS use
 - ◆ Disclosing how payday loan costs can add up over time and the total cost of rent-to-own purchases have been found to reduce product use (Bertrand and Morse 2011; McKernan et al. 2003)

Restrictive AFS Policies are Associated with Reduced AFS Use



ARE RESTRICTIONS ON ONE AFS PRODUCT ASSOCIATED WITH INCREASED USE OF OTHER AFS PRODUCTS?

- ◆ No evidence that prohibitions and price caps on one AFS product lead consumers to use other AFS products
- ◆ Our result is consistent with a recent study that finds no evidence that payday restrictions in Oregon led to increased use of auto title loans (Zinman 2010)
 - ◆ Zinman does find evidence of a substitution between payday loans and both checking account overdrafts and late bill payment
 - ◆ Theodos et al. (2010) do find restrictions on one AFS product led to increases in another
 - ◆ Restrictions on RALs by the military lead to large increase in RACs

HOW ARE DEMOGRAPHIC AND ECONOMIC CHARACTERISTICS RELATED TO AFS USE?

- ◆ AFS users tend to be:
 - ◆ Young
 - ◆ Less educated and have lower levels of financial knowledge
 - ◆ African American
 - ◆ Living in a cohabiting relationship or living with others (but not parents)
 - ◆ Financially responsible for more children
 - ◆ Lower income
 - ◆ Unbanked (pawnshop and RAL)

SUMMARY AND CONCLUSION

- ◆ Stringent price caps and prohibitions are associated with reduced use (consistent with reduced supply)
- ◆ Restricting supply can increase consumer well-being when it restricts high-priced suppliers but can reduce consumer well-being if consumers turn to inferior products or options to deal with credit needs
- ◆ Encouraging mainstream alternative products may improve consumer well-being
- ◆ Standard, clear, and timely disclosures of the total cost
- ◆ Facilitate and incentivize saving among low-income families