JUST UNTIL PAYDAY

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Abstract

The growth of payday lending markets during the last 15 years has been the focus of substantial regulatory attention both here and abroad, producing a dizzying array of initiatives by federal and state policymakers. Those initiatives have conflicting purposes – some seek to remove barriers to entry and others seek to impose limits on the business. As is often the case in banking markets, the resulting patchwork of federal and state laws poses a problem when one state is able to dictate the practices of a national industry. For most of this industry's life, just that has happened – the ability of lenders to take advantage of the laws of the least restrictive States has effectively displaced the laws of more restrictive States. Recently, however, significant changes in the policies of federal regulators have limited the ability of lenders to "export" less restrictive laws. Hence, States can effectively police payday lenders in their borders for the first time.

Yet as we enter an era in which States will be able to regulate payday lending effectively, there has been little clear analysis of how they should do so. This paper responds by providing a detailed explanation of the business models and regulatory regimes that exist today, together with a framework of options designed to implement various perspectives regulators might adopt. We emphasize three main points. The first is the unusual nature of payday lending, with very high interest rates accruing against necessarily limited debt amounts. Unlike credit card lending, the payday loan amount does not increase over time, but the biweekly interest obligation can lead to a semi-permanent cash annuity for the lender. In our view, those features present challenging issues for regulators. Second, we underscore the limitations of existing legal regimes, which often leave loopholes that permit lenders to avoid the statutory framework; this is a particularly serious problem for the majority of States that have tried to limit rollover lending. Third, addressing the majority of jurisdictions that have not banned payday lending, we advocate a reversal of the current hostility to market activity by large institutions. If the market is to exist, we believe it is better for it to be populated by highly visible national providers than by smaller "mom and pop" providers.