Payday Lenders Provide Desired Service to Lower and Moderate Income, Middle-Educated, Young American Families

"*An analysis of Consumers' Use of Payday Loans*" by Gregory Elliehausen, Division of Research and Statistics, Board of Governors of the Federal Reserve System and Financial Services Research Program, The George Washington University School of Business, describes the demographic characteristics of payday loan customers and considers whether they make rational decisions and if they benefit from access to credit.

Elliehausen notes that only 2% of U.S. adults use payday loans at any one time and provides a detailed picture of the typical payday loan customer, including who they are, how they use the service and their decision-making process.

According to the monograph, customers that use payday loans:

- Skew young; 63% have children at home
- Have lower and middle incomes; 41% earn between $25,000 and $50,000; 39% report incomes of $40,000 or more
- Are educated; 90% have a high school diploma or better, with 54% having some college or a degree
- Have limited liquid assets and savings, most use other forms of credit
- Have characteristics that may limit their access to credit
- Use payday loans moderately, as intended for short-term use
- Are aware of the cost of their most recent payday loan
- Consider the alternatives, are satisfied with their decision
- Benefit by having access to payday loans

Elliehausen concludes that, "Most payday loans are used to pay unexpected expenses or expenses that could not be postponed…If payday loan customers live from paycheck to paycheck with very little discretionary income, even small expenses may cause financial problems and make emergencies a frequent event. In such cases, even frequent use of payday loans may be better than the alternatives."

Full monograph available at http://www.business.gwu.edu/research/centers/fsrp/pdf/m41.pdf.

- **Customers skew young; 63% have children at home**

"By far, most payday loan customers were in younger age groups, which tend to use relatively large amounts of credit. Most payday loan customers were less than 45 years of age in 2007, and three-fourths were less than 55."

"Ten percent of payday loan customers were 65 years or older. This percentage is considerably less than the 19.9 percent of all consumers who were 65 years or older."

"…More than half (62.7 percent) of payday loan customers were from families with children."

- **Customers have lower and moderate incomes**

"Payday loan customers largely do not have profiles similar to the typical fringe banking customer…The requirement that customers have a checking account prevents many low-income consumers from qualifying for a payday loan."

"A large percentage of payday loan customers had higher incomes. Thirty-nine percent of payday loan customers had incomes of $40,000 or more, about a quarter had incomes of $50,000 or more, and 8.9 percent had incomes of $75,000 or more."

"…It is notable that the higher income customers (income ≥ $50,000) are a larger share of payday loan customers than lower income (income < $15,000) customers."

- **Customers are educated; 90% have high school diploma or better**

"Almost all payday loan customers had a high school diploma or higher education, but customers were concentrated in the middle levels of educational attainment."

"Payday loan companies do not draw heavily on consumers from the lowest and highest education attainment groups."

- **Customers have limited liquid assets and savings**

"Payday loan customers' liquid assets are quite limited. Fewer than half (44.7 percent) of payday loan customers reported having savings or reserve funds in 2007…The size of most payday loans [$315] suggests that customers' checking and savings balances could not have been very large."

"Most payday loan customers did not save regularly. Thirty-six percent of customers reported spending all the income that they receive, and 33.4 percent reported saving whatever was left over at the end of the month. Just 29.0 percent of payday loan customers said that they regularly set aside money for savings."

- **Nearly all customers use other forms of credit, but may have limited access**

"Eighty-five percent of customers used other types of consumer credit in 2007."

"…Payday loan borrowers were less likely to have open-end credit than all consumers. Fifty-four percent of payday loan customers had a bank credit card, compared to 74.5 percent of all consumers; and 21.7 percent of payday loan customers had a retail credit card, compared to 50.4 percent of all consumers.

"Fifty-five percent of payday loan customers experienced credit limitations in the previous five years. An even higher percentage of customers considered applying for credit but did not because they thought that they would be denied."

"Many more consumers are credit constrained than use payday loans. According to the Survey of Consumer Finances, 25.7 percent of consumers had incomes less than $50,000 and were under 45 years of age or unmarried with children. Nearly half of these consumers in the last five years had been turned down or did not apply for credit because they thought they would be turned down. Thus, being credit constrained does not by itself appear to be sufficient to cause consumers to turn to payday loans."

- **Customers use payday loans moderately, for short-term use to deal with unexpected expenses**

"The stimulus by far for most payday loans was an unexpected expense or an expense that could not be postponed. Seventy percent of payday loan customers agreed strongly with the statement "I had an unexpected expense that could not be postponed." Forty-seven percent agreed strongly with the statement "I knew that an expense was coming but did not have the cash when the expense was due."

"The survey evidence indicates that most customers used payday loans as a short-term source of financing. They used payday advances a small or moderate number of times during the past year, typically for less than a month at a time...Such use seems consistent with the intended purpose of payday loans as short-term borrowing to pay unexpected expenses or relieve temporary shortfalls in income."

"Frequent use is not necessarily evidence of a debt trap, however. If payday loan customers live from paycheck to paycheck with very little discretionary income, even small expenses may cause financial problems and make emergencies a frequent event. In such cases, even frequent use of payday loans may be better than the alternatives."

"Most payday loan customers had relatively short sequences of consecutive loans (which include a new loan and subsequent renewals). Thirty-five percent of customers reported that their longest sequence was two weeks or less. Another 29.4 percent reported longest sequences between 3 and 4 weeks."

"Few payday loan customers considered payday loans as a debt trap. Only about three percent of payday loan customers mentioned difficulty of getting out of debt as a reason for being dissatisfied or only partially satisfied with their most recent new payday loan."

- **Customers are aware of the cost of their most recent payday loan**

"…nearly all payday advance customers are aware of the finance charges for their most recent new payday advance. That customers are aware of the finance charge suggests that this measure of cost is useful and relevant to them. They can readily compare the finance charge for a payday loan with a dollar amount of savings or avoided costs from use of a payday loan to make a decision."

"Payday loans are a simple product. Price is the key term. Payday loan customers receive two price disclosures, the finance charge and annual percentage rate. Truth in Lending requires disclosures of these two prices. Customers likely would be aware of the finance charge regardless of regulation since the finance charge is the difference between the amount of the check and the amount of cash they receive."

"Eighty-one percent of payday loan customers recalled receiving information on the annual percentage rate for their most recent new payday loan, but far fewer customers were able to recall the actual annual percentage rate…That most payday loan customers are not aware of the annual percentage rates suggests that they may not have found the annual percentage rate very useful in their most recent decision. Penalties, late fees, or other costs that customers save through use of payday loans are not normally expressed as annualized percentages."

- **Customers consider the alternatives, deliberate, and are satisfied with their decision**

“Nearly half [46.4 percent] considered other sources of credit before obtaining a payday loan. The most frequent other source was a friend or relative, but a bank, finance company, or credit union were also frequently mentioned.

“Despite the urgency, the small size of the loan relative to income, and perception that few alternatives were available, many payday loan customers showed signs of deliberation in their decisions.”

“…overall, 50.6 percent of customers reported believing that a payday loan was their only choice at the time they obtained their most recent new payday loan.”

“Many customers perceived that they had few options to payday loans. Less than one-fifth of customers had sufficient funds in a checking and savings account. Customers frequently either did not have a credit card or if they had a credit card would have exceeded their credit limit. A considerable percentage of customers believed that they could have borrowed from a friend or relative.”

“Nearly all payday loan customers said that they were satisfied or somewhat satisfied with their most recent new payday loan. Receiving the funds quickly, the easy loan process, and courteous treatment accounted for by far most reasons for satisfaction.”

- **Customers benefit by having access to payday loans**

“By far most customers agree that payday loan companies provide a useful service to consumers (86 percent) and that most people are satisfied in their dealings with payday loan companies (75.8 percent).”

“Fifty-nine percent of customers disagreed that the government should limit the number of payday loans they can get in a year.”

“…The predominant users of payday loans are consumers that economic theory predicts are most likely to benefit from high-price consumer credit.”

“Payday loans may be a transitional product for many consumers: As families age and income rises, consumers may become less vulnerable to financial distress.”

“In giving consumers access to additional credit for unexpected expenses or shortfalls in income, payday loans give the consumers a little control over their financial situations that they otherwise would not have.”