

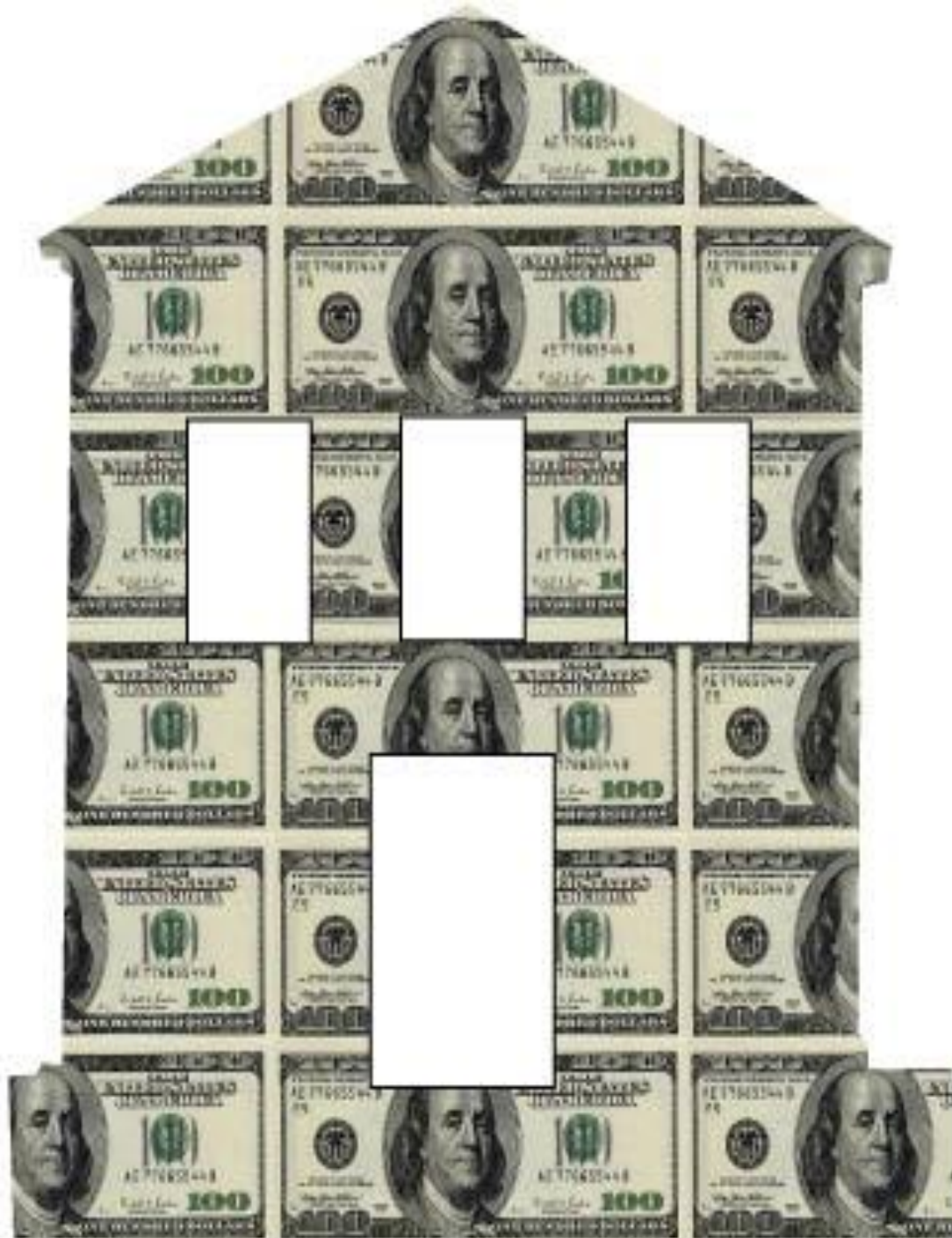
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The Hispanic Institute

Washington D. C.

Thinking Outside the Banks:

Hispanic Access To Non-Traditional Credit Sources



Thinking Outside the Banks: Hispanic Access To Non-Traditional Credit Sources

The Hispanic Institute (THI) provides an effective education forum for an informed and empowered Hispanic America. THI's work is focused in the following areas:

- The study of Hispanic and immigrant economic contributions
- Media monitoring
- Consumer fraud protection
- Citizenship education
- Technology, telecommunications, and the Digital Divide
- Financial services
- Energy

THI has produced studies on such topics as Hispanics and Retirement, Calling Card Fraud, Hispanic Broadband Access, Interchange Fees, and Immigration and Labor. In addition, the Institute has developed media education campaigns on crucial issues such as Immigration Reform, Labor and Business, Net Neutrality, The Digital Divide, and Interchange Fees.

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EXECUTIVE SUMMARY

For Hispanics and other low income communities, access to credit – and sometimes the lack of it – continues to be a priority for the community to thrive. For individuals, access to credit sources becomes critical in light of the dramatic economic changes the country has endured in the last two. For those individuals living from paycheck to paycheck, even minor emergencies pose a significant risk to standard of living, their well-being and their financial stability.

For some individuals, relying on nontraditional sources of funds to handle periodic emergencies becomes a last hope after they have been denied access to traditional sources (banks, credit unions, credit cards, etc.). Specifically, the use of payday lenders as a source of funds has become a growing option for Hispanic families. However, possible legislative action may affect the ability of Hispanics to access this source of credit. The Hispanic Institute developed this study to examine the impact of payday lending and potential legislative/regulatory changes for payday lending operations on Hispanics.

KEY FINDINGS

- There are more than 48 million Hispanics in the United States.
- Although 81% of Hispanics are concentrated in 10 states (California, Texas, Florida, New York, Illinois, Arizona, New Jersey, Colorado, New Mexico and Georgia), Hispanics live in all 50 states.
- Population projections indicate that there will be 132 million Hispanics in the U.S. by 2050, accounting for more than 30% of the total U.S. population.
- The median age for Hispanics is 27.3 years of age, compared to 36.4 years for the overall U.S. population and 39 years for non-Hispanic Whites.
- More than 40% of Hispanics have less than a high school diploma, and 27.8% have attained only a high school diploma.
- A mere 8.4% of Hispanics have earned a bachelor's degree, compared with 17% for the country at large.
- The per capita income for Hispanics is just \$15,190, compared to \$17,123 for African Americans, \$26,178 for the U.S. population as a whole, \$28,637 for Asian Americans, and \$28,953 for Whites.
- Although Hispanics work in all sectors of the economy, they are more heavily concentrated in lower paying blue collar jobs.
- Roughly two-thirds of Hispanics are employed in service-related jobs, while just 17% work in traditionally higher-paying management jobs and other traditional white-collar occupations.
- In 2006, the percentage of Hispanics with an existing relationship with a bank was estimated to be from 30-50%.

- Hispanics have suffered from discriminatory lending practices, including outright discrimination, redlining, excessive threshold requirements, higher interest rates and other unfair practices.
- Even with the advent of fair lending legislation, Hispanics still frequently lack access to credit services.
- Banks are less likely to be located in minority neighborhoods, making access to credit services even harder.
- The lack of credit translates to negative impacts on whole neighborhoods, leading to dilapidated housing, business closures and lack of services provided by those businesses
- In making credit decisions, Hispanics consider several options, include foregoing certain purchases or payments (rent/mortgage, health care, transportation, utilities, credit cards, food, and the fees and negative consequences associated with not making those payments/purchases) or acquiring a payday loan.
- By its nature, payday lending is among the last options after other traditional credit sources have been exhausted.
- In the market, competition among payday lenders has proven an effective way to lower fees.
- The extreme policy of outlawing payday lending has had the most adverse impact on Hispanics and other low-income borrowers.
- Borrowers are significantly more likely to experience an adverse change in financial conditions after payday loans are prohibited.

As new policies are being considered, it is essential that any legislative or regulatory changes still allow for access to credit services for low income families. Any changes that constrain access to credit services will have long-term negative impacts for the Hispanic community.

INTRODUCTION

The dramatic economic storm that enveloped the country during 2008 and 2009 has focused renewed attention on the precarious position in which many Hispanics and others have found themselves. As the economy faltered, many people have lost their jobs or seen their earnings reduced dramatically. This has resulted in a serious reduction in disposable income for marginal and low-income families who are barely able to maintain their financial stability from paycheck to paycheck.

For many, the economic downturn has resulted in having to rely on nontraditional sources of funds to handle periodic emergencies for which they are often not prepared. Specifically, the use of payday lenders as a source of funds has become a growing option for Hispanic families. However, possible legislative action may affect the ability of Hispanics to access this source of credit. The Hispanic Institute developed this study to examine the impact of payday lending and potential legislative/regulatory changes for payday lending operations on Hispanics.

BACKGROUND

Much has been written on this issue by industry advocates and critics. However, much of it has been couched in hyperbole and exaggeration, leaving significant space for more measured analysis of the issue. This report looks at a variety of questions related to the payday lending and its impact on Hispanics. It includes a demographic profile of Hispanics, a brief history of credit issues in the Hispanic community, and how Hispanics and other low-income people make decisions about credit choices. It also examines how payday lending fits into decision-making by Hispanics on credit choices, and it draws some conclusions about the effects of proposed legislative changes that would affect Hispanics' access to credit services.

THE HISPANIC POPULATION

There are more than 48 million Hispanics in the United States¹. As a group, Hispanics comprise a diverse population made up of a number of distinct cultures and demographics. Among Hispanics, people of Mexican descent are the largest group by far, with a population of 28,165,623 – almost two-thirds (63.98%) of the total Hispanic population in the U.S. Mexican-Americans are followed by Puerto Ricans at 3,998,264; Central Americans at 3,361,269; South Americans at 2,395,914; Cubans at 1,535,236; Dominicans (Dominican Republic) at 1,183,365; and Spaniards at 369,214².

Although 81% of Hispanics are concentrated in 10 states (California, Texas, Florida, New York, Illinois, Arizona, New Jersey, Colorado, New Mexico and Georgia), Hispanics live in all 50 states. As a percentage of their respective state populations, Hispanics are most concentrated in New Mexico (44%), followed by California (36%), Texas (36%), Arizona (29%), Nevada (24%),

¹ U.S. Census Bureau 2008 Population Estimates

² U.S. Census, 2005-2007 American Community Survey

Florida (20%) and Colorado (20%)³. Whether as a total population or as a percentage of the population, Hispanics are largely located in the Southwest and the East Coast. Approximately 38% of Hispanics are immigrants while 62% are native born.

Hispanics currently represent a significant segment of the American population, and they are expected to become an even larger community in the future. U.S. Census Bureau projections indicate that there will be 132 million Hispanics in the U.S. by 2050, accounting for more than 30% of the total U.S. population.

Table I: Projections of the U.S. Population: 2010 to 2050*
(Numbers in thousands)

	2010		2050	
	Population	Percent	Population	Percent
Total	320,233	100.00%	439,010	100.00%
White	200,853	62.72%	203,347	46.32%
Hispanic	49,726	15.53%	132,792	30.25%
Black	37,985	11.86%	51,949	11.83%
Asian	14,083	4.40%	33,418	7.61%

Source: U.S. Census Bureau, 2008 Population Projections

*Numbers and % do not add up since numbers have been rounded.

As a group, Hispanics are younger and less educated than the overall United States population. The median age for Hispanics is 27.3 years of age, compared to 36.4 years for the overall U.S. population and 39 years for non-Hispanic Whites. More than 40% of Hispanics have less than a high school diploma, and 27.8% have attained only a high school diploma. A mere 8.4% of Hispanics have earned a bachelor’s degree, compared with 17% for the country at large. The low high school and college graduation rates for Hispanics are reflected in earning power. The per capita income for Hispanics is just \$15,190, compared to \$17,123 for African Americans, \$26,178 for the U.S. population as a whole, \$28,637 for Asian Americans, and \$28,953 for Whites⁴.

EDUCATION, INCOME AND OCCUPATIONAL TRENDS

The lower educational attainment of Hispanics in the U.S. diminishes their employment opportunities, their income potential and thus their capacity to accumulate savings.

Education

As noted above, Hispanics tend to have lower educational levels than the U.S. population overall. Almost one quarter of Hispanics over 25 years of age have less than a ninth grade

³ 2005-2007 American Community Survey

⁴ Ibid

education, compared to less than 7.41% of non-Hispanics in the U.S.⁵ Hispanics also lag behind the general population in post-high school education levels. Only 9% of Hispanics have a bachelor's degree, compared to 17% of the U.S. population.⁶

Income

The low educational attainment of U.S. Hispanics has a direct impact on their earning power, as reflected in median household income levels. In 2006, the average per capita income for Hispanics was \$14,736, compared to \$25,267 for the total population and \$27,951 for non-Hispanics.⁷ At the same time, however, statistics suggest a growing Hispanic middle class. Between 1979 and 1999, middle-class Hispanic households increased nearly 80%.⁸ Hispanic households earning an annual income of \$40,000 to \$140,000 grew to include about one-third of all Hispanic households nationwide.⁹

Slightly more than 20% of Hispanics live in poverty, compared to 13.3% for the general population.¹⁰ The percentage of Hispanics living in poverty is less than it was two decades ago, but recent data indicate that poverty levels have begun to climb somewhat since 2000. In 1990, 25% of Hispanics were living in poverty, and by 2000, this number had dropped to 19.2%, an average decrease of 0.7% per year. From 2000 to 2006, however, the percentage of Hispanics living in poverty increased, rising from 19.2% to 20.6%, an average annual increase of 0.2%.¹¹

A comparatively lower net worth also affects Hispanics' capacity to prepare for emergencies. The median net worth of Hispanic households in 2002 was \$7,932 – more than the median African American household's net worth, at \$5,988 – yet just 9% of \$88,651, the median net worth of non-Hispanic White households in the U.S.¹²

Occupational Trends and Impact on Emergency Savings

Although Hispanics work in all sectors of the economy, they are more heavily concentrated in lower paying blue collar jobs. Roughly two-thirds of Hispanics are employed in service-related

⁵ 2006 American Community Survey

⁶ Ibid

⁷ Ibid

⁸ Trejo, S., Capps, R. and Tyler, M. "The Latino Middle Class: Myth, Reality, and Potential," Tomás Rivera Policy Institute, 2001.

⁹ Ibid.

¹⁰ 2006 American Community Survey

¹¹ U.S. Bureau of the Census

¹² Kochhar, R. "The Wealth of Hispanic Households: 1996-2002," Pew Hispanic Center, 18 October 2004

jobs, while just 17% work in traditionally higher-paying management jobs and other traditional white-collar occupations.

Table 2: Median earnings and ethnicity by selected occupations¹³

Occupations	Median Earnings	Total	White	Hispanics	Hispanic Females	Hispanic Males
Management, Professional & related	\$46,246	34.09%	35.93%	17.43%	22.64%	14.02%
Service	\$15,911	16.29%	14.55%	23.61%	29.43%	19.79%
Sales & office	\$25,771	25.91%	26.31%	21.58%	33.36%	13.85%
Farming, fishing & forestry	\$15,896	0.68%	0.65%	2.28%	1.3%	2.92%
Construction, extraction & maintenance	\$31,306	9.99%	10.39%	16.36%	0.91%	26.5%
Production, transportation & material moving	\$26,658	13.05%	12.17%	18.74%	12.36%	22.92%

The types of jobs Hispanics hold impact their immediate income, as well as their ability to accumulate savings for future needs and emergencies. As detailed in Table 2, more than 45% of Hispanics are employed in service industries, which traditionally pay less than other industries. Consequently, Hispanics tend to have less disposable income with which to accumulate savings.¹⁴

UNBANKED

A challenge for some Hispanics when trying to accumulate savings is not having a bank account, particularly those who are in the lower income brackets. The most common groups of so-called “unbanked” individuals in the United States are those with low income and low education levels, households led by single females or young adults, residents of rural communities, and recent immigrants. According to the Federal Reserve Board, slightly more than 9% of all American families are among the unbanked, but for Hispanics, the number is much larger – approximately a quarter of the population.¹⁵ In 2006, the percentage of Hispanics with an existing relationship with a bank was estimated to be from 30-50%.¹⁶

Generally speaking, the lower the income, the greater the likelihood that an individual will be unbanked. This is especially true for the Hispanic demographic. More than 50% of unbanked Hispanics in the U.S. have an annual income of less than \$15,000 a year, and 25% of unbanked

¹³ U.S. Census Bureau, 2005 American Community Survey

¹⁴ U.S. Bureau of Labor Statistics, 2006

¹⁵ FDIC (2009) National Survey of Unbanked and Underbanked Households, Federal Deposit Insurance Corporation

¹⁶ RightMinds (2008). Growing the Underserved Banking Marketplace: Reaching the Hispanic Consumer, Richmond VA.

Hispanics have an annual income of \$15,000 to \$30,000.¹⁷ Without bank accounts and related financial services, it is more difficult to accumulate savings.

While unbanked individuals generally earn under \$20,000 annually, in aggregate they earned and spent nearly \$510 billion in 2006. Among families without a checking account in 2004:

- 52.1% had previously owned a checking account;
- 55.1% had incomes in the lowest 20% of the population;
- 56.6% were headed by persons younger than 45; and
- 61% were non-White or Hispanic.¹⁸

Research indicates that many of the unbanked may initially be attracted by offers of “free checking” but are turned off by hidden or unexpected fees that lead them to abandon relationships with banks¹⁹. For many of the unbanked, the availability of traditional banking services has a limited value. Bank fees, by their nature are recurring and a drain to account holders. Although so-called “free checking” accounts may sound attractive, consumers often learn otherwise. Under the Federal Truth and Savings Act²⁰, a free checking account cannot require a minimum balance or a maintenance or activity fee. However, there are numerous fees a bank can charge and still claim to offer free accounts, including fees for nonsufficient funds, stop payments, check printing, dormant accounts and even for closing an account.

Although the vast majority of Hispanics are employed, many of them are also unbanked, and they need to find ways to cash their paychecks. For many, check cashing options include using check-cashing stores and other similar operations that charge a fee for the transaction. In working class neighborhoods, even grocery and department stores have developed such businesses. This history of using check-cashing stores provides an easy link for payday loans – short-term loans for a fee – that are often affiliated with or located in the same area as payday loan companies²¹.

Immigrants, particularly recent arrivals, are often among the unbanked. Many send money to their families in their home countries, often relying upon wire transfer services similar to those with which they are familiar in their home countries. Because many of these wire transfer services are located in neighborhood check-cashing stores, payday loan company branches,

¹⁷ Federal Reserve Board 2001

¹⁸ RightMinds 2008

¹⁹ Ibid

²⁰ Federalreserve.gov 2010

²¹ Flannery, M. & Samolyk, K. (2005) Payday Lending: Do the Costs Justify the Price? FDIC Center for Financial Research Working Paper No. 2005-09.(Federal Insurance Deposit Corporation 2006)(Federal Insurance Deposit Corporation, 2006)

grocery stores and department stores, the immigrants quickly become familiar with those services²².

As will be discussed in the next section, there is often a dearth of traditional banks in minority neighborhoods. As a result, unbanked, but employed, Hispanics can find access to alternate financial services in their neighborhoods, including payday lending.

HISTORICAL CREDIT TRENDS

For Hispanics, access to credit has long been a challenge. Along with African-Americans and other minorities, Hispanics have suffered from discriminatory lending practices, including outright discrimination, redlining, excessive threshold requirements, higher interest rates and other unfair practices. Even with the advent of fair lending legislation, Hispanics still frequently lack access to credit services. Moreover, banks are less likely to be located in minority neighborhoods, making access to credit services even harder²³.

Minority neighborhoods are less likely to have banking services and are more likely to lose services when branches are closed as a result of bank consolidations²⁴. The lack of access to credit impacts more than the individual borrowers. The lack of credit translates to negative impacts on whole neighborhoods, leading to dilapidated housing, business closures and lack of services provided by those businesses²⁵.

One of the reasons for the growth of the payday lending industry is that traditional financial institutions found it too expensive to market and service such small loans for such short periods of time. According to one estimate from the Federal Reserve, it would cost approximately \$175 for a traditional bank to fund and service a typical payday loan, far above the normal fees charged for a \$300-\$500 loan. Additionally, unlike payday loan companies that have to cover all the traditional overhead costs and acquire their lending capital at market rates, banks can rely on customer checking and savings accounts (at almost no cost in some cases) and funds at below market rates from the Federal Reserve.²⁶

²² FDIC 2009.

²³ Dingemans, D. (1979) Redlining and Mortgage Lending in Sacramento. *Annals of the Association of American Geographers*, 69(2).

²⁴ Figlio, D., & Genshlea, J. (1999). Bank Consolidations and Minority Neighborhoods. *Journal of Urban Economics*, 45(3), 474-489. Retrieved from EconLit database.

²⁵ Aalbers, M. (2006). When the Banks Withdraw, Slum Landlords Take Over: The Structuration of Neighbourhood Decline through Redlining, Drug Dealing, Speculation and Immigrant Exploitation. *Urban Studies*, 43(7), 1061-1086. Retrieved from EconLit database.

²⁶ Flannery, M. & Samolyk, K. (2005) Payday Lending: Do the Costs Justify the Price? FDIC Center for Financial Research Working Paper No. 2005-09

CREDIT AND DECISION-MAKING

The saying, “It takes money to make money,” is one way to look at the importance of access to credit. All individuals, families and communities need access to credit in order to create and accumulate wealth²⁷. Access to credit is also essential to maintain and increase a desirable standard of living. It is a fundamental need for all communities and groups. While many of the civil rights issues critical to people of color have focused on issues of education, housing and employment as means of improving their economic well-being, access to credit is the underlying element that often has a more immediate impact on wealth accumulation. For individuals or families seeking to start small businesses or to meet other immediate needs, access to credit can be the critical element that makes the difference²⁸.

Although credit access is a wide field, encompassing business loans, home mortgages, car loans, credit cards and personal loans, among others, this report focuses on personal loans, specifically payday loans, a type of credit that plays a critical role for many communities in this country.

Many of the overall economic conditions Hispanics face can be traced to the lack of credit access, which is often the result of low income levels, poor job stability and substandard credit histories. But for many, these factors are irrelevant to the decision to use non-traditional banking services. By one estimate, having a traditional banking relationship would really only help approximately 17% of the unbanked, making traditional banking relationships more of a burden than a benefit²⁹. Thus, it would appear that many of the unbanked are actually making deliberate, informed financial decisions with respect to how to manage their accounts.

When they decide to resort to check cashing operations, these consumers are not necessarily financially illiterate, as might be assumed, but rather they are actually making informed decisions based on a variety of factors, such as proximity and the absence of the need for long term commitments. Many of these operations are in their neighborhoods, unlike traditional banks that have demonstrated their unwillingness to locate branches in poorer communities. Also, many of the check cashing operations are open late, some with 24-hour schedules and hours on weekends and holidays, when traditional banks are closed. These conveniences are also attractive to shift workers and others who work odd hours, regardless of ethnicity³⁰.

It would be easy to assume, given the relatively low educational attainment of Hispanics, as compared to Whites, that they are financially unsophisticated. Coupled with the language barrier for some, this lack of formal education could lead to a simplistic conclusion that they are also financially uneducated and make uninformed financial choices. However, such perceptions of knowledge and intelligence give too much weight to an understanding of formal

²⁷ Stegman, M. (2001). The public policy challenges of payday lending. *Popular Government*, 66(3), 16-22.

²⁸ Ibid

²⁹ RightMinds, 2008

³⁰ Wilson, B. J., Findlay, D. W., Meehan, J. W., Wellford, C. P. & Schurter, K, (2008) An Experimental Analysis of the Demand for Payday Loans. Available at SSRN: <http://ssrn.com>

financial analysis and too little recognition of real-world experience. When a problem — such as a financial transaction that includes calculation of comparative interest costs and fees — is presented in an abstract format, a person with little financial education might have trouble understanding it. Yet, the same person might successfully run small businesses and be self-employed.³¹ In other words, this is what some might refer to as “street smarts,” the ability to make knowledgeable, real-world decisions while lacking formal education or training.

Moreover, Hispanic immigrants are often unfamiliar with the American banking system. In many cases, they come from countries where banking fraud and financial upheaval are prevalent. This often leads to their being wary of banks overall. Additionally, the language barrier often makes it difficult for them to feel comfortable in American banks³².

THE IMPACT OF USING PAYDAY LOANS

It is generally agreed that payday loans are a last resort for many borrowers. Payday customers often have been denied other forms of credit or secured less credit than what they need. They are also more likely to have credit problems or limited credit availability³³. This paper does not go into extensive detail about how payday lending works. There are many other sources that can provide that information in much greater detail. This includes sources from critics and supporters of payday lending operations.

Here, however, is a simple description:

A borrower will secure a loan from a lender for a short period, usually two weeks. In return for the cash, the borrower provides the lender with a pre-dated check for the amount of the loan plus a fee, which typically ranges from \$10 to \$15 per \$100 borrowed. The fee, date of loan maturation and maximum lending amount vary from state to state. (In some states, these types of loans are barred completely.) At the end of the maturation period, the lender can deposit the check and receive payment. This assumes that the borrower’s account has sufficient funds to cover the check. If this is the case, the transaction is complete. However, if the borrower does not have enough funds in the checking account to cover the check, he or she has the option to secure funds from other sources, make a payment for the full amount and then get the check back. If the borrower cannot meet the obligation in either of those ways, lenders can choose to renew the loan in return for another cycle and another fee.

³¹ Sternberg, R. J. (2002). Cultural explorations of human intelligence around the world. In W. J. Lonner, D. L. Dinnel, S. A. Hayes, & D. N. Sattler (Eds.), *Online Readings in Psychology and Culture* (Unit 5, Chapter 1), (<http://www.wvu.edu/~culture>).

³² FDIC (2009)

³³ Elliehausen, G., & Lawrence, E. C. (2001). *Payday Advance Credit in America: An Analysis of Customer Demand*. Washington D. C.: Georgetown University.

There are several issues to consider in this transaction cycle. First, the original fee in the example can be seen or labeled in various ways. Depending on the state where the loan is originated, it may or may not be called an interest charge. In the example, a \$15 fee per \$100 borrowed may be viewed as a 15% charge. In and of itself, this charge is not exorbitant. Most borrowers can afford \$15.

The problem arises when a borrower renews the loan several times. With each successive renewal, the total fee increases. Anecdotal evidence suggests that some borrowers renew loans multiple times, or repeatedly borrowed money from one or more payday lenders. There is no definitive data on how many borrowers renew a given loan or how many are repeat borrowers. (Note: Because payday lenders are generally not covered by federal regulation and do not report their data to a central location, this makes it difficult to find definitive data available to the public on such operations.)

However, the claim made by critics that payday lending costs run as high as 300-400% would only be accurate if a borrower continues a loan over an entire year. Since the data suggests that most borrowers do not renew a loan more than once, the declaration of 400% interest rates is not really accurate. Taking a \$15 fee and extrapolating it on an annualized basis (Annual Percentage Rate—APR) to mean 390% is inaccurate and does not play into an individual's need and decision to get a loan.

Whether the cost of the loan is called an interest rate charge or by some other name, the specific term colors the debate but does not change the underlying decision-making process a borrower goes through in securing a payday loan. The debate often engages the term, predatory lending, which is subjective and has no generally accepted definition in legal terms or economic analysis. The academic literature provides no accepted definition of the term, making a clear analysis difficult to discern. There are generally two points associated with this term that deserve clarification. The first is that the fees charged are excessive. The second is that such lenders prey on minorities and low-income individuals.

Calling fees excessive is also a subjective term, because in our view, there is also no accepted demarcation line of where a fee starts or stops being excessive. It can generally be understood that "excessive" is a relative term. In economic terms, this is the opportunity cost, "the value of the next-highest-valued alternative use of that resource"³⁴. Consumers must make choices among several options. These options include foregoing certain purchases or payments (rent/mortgage, health care, transportation, utilities, credit cards, food, and the fees and negative consequences associated with not making those payments/purchases) or acquiring a payday loan³⁵. In determining their opportunity costs, consumers must weigh which option has the highest value. If the payday loan has a higher value, compared to the value of foregoing certain purchases/payments, then it would not be excessive for that consumer. Without knowing it, consumers weigh their opportunity costs every day. For consumers with access to

³⁴ Henderson, D. R. (2008). *Opportunity Cost*. Retrieved March 2, 2010, from The Concise Encyclopedia of Economics: <http://www.econlib.org/library/Enc/OpportunityCost.html>(Henderson, 2008)

³⁵ Zywicki, T. J. & Arca, A, (2008) The Case Against New Restrictions on Payday Lending. Mercatus Center at George Mason University.

savings or a number of credit sources, the options may provide greater flexibility. For consumers without savings and a limited number of credit sources, the opportunity costs determine where they seek credit.

Associated with this point is the charge that payday loans draw borrowers into a cycle of loan renewals or rollovers. This assumes that the borrowers roll over a loan with mounting fees that make it extremely difficult for the borrower to pay it off. Anecdotal evidence points to cases where some borrowers have done this. There are no definitive public data that identify how many borrowers are in this situation. Moreover, there is no definitive data to suggest that it is a significant number³⁶.

Payday lenders are also called predatory because minority and low-income working families seem to be the bulk of their customer base. Minorities (primarily African Americans, Hispanics and immigrants) are more likely to fall within the low income working sector. The largest segment of payday loan customers earn an annual income of \$25,000-\$50,000, and almost 70% of borrowers are under 45 years of age, the prime working years³⁷.

By its nature, payday lending is among the last options after other traditional credit sources have been exhausted. Given that payday loans depend upon a person having both a steady job and an active checking account, it is logical to see why the industry seeks this market. More affluent customers are more likely to have savings and greater access to credit for emergencies, thus having less need to resort to payday loans³⁸.

As in any industry, payday lenders locate as close to their customer base as possible. In the same way that traditional banks prefer to locate closer to their prime customers, commercial markets and affluent populations, payday lenders tend to cluster in working-class neighborhoods for obvious reasons. Because of their limited income, working class families have fewer options and resources to deal with economic emergencies³⁹. Using the term “predatory” for an industry that serves working class families makes no more sense than saying that stores located in malls prey on suburban families.

Again, consumers make rational decisions based on their circumstances and within the context of their environment, “street smarts” as identified earlier. Based on the previous example of a \$15 fee per \$100 borrowed, a \$300 loan would result in a \$45 charge. Although there are no complete data about how borrowers use their funds, anecdotal evidence suggests that they use loan proceeds for basic living expenses and emergencies, including rent/mortgage, food, car payments, medical/pharmaceutical expenses, car and home repair, emergency travel and normal

³⁶ Skiba, P. M., & Tobacman, J. B. (2009). *Do Payday Loans Cause Bankruptcy?* Working Paper Series. Available at SSRN: <http://ssrn.com/abstract=1266215>

³⁷ Elliehausen & Lawrence (2001)(Elliehausen & Lawrence, 2001)

³⁸ Ibid

³⁹ Ibid

bills such as utilities, telephone and credit card charges. For borrowers, the choice is borrowing at whatever price lenders set or be without essential necessities. In practical terms, borrowers must sometimes weigh the cost of losing an apartment, a car, or electricity/heating services against the need for money to purchase other necessities like life-saving medicines. Thus, the need for alternative credit sources is created⁴⁰.

Borrowers have the capacity to make a rational choice between the cost of the loan, \$45 in this case, and the cost of relocating a household, losing equity in a house, a car or reconnecting utilities. Relocating to a new apartment can run upwards to \$1,000 in first and last months' rent, security deposits, connection of utilities and other expenses. Opting for a payday loan becomes an obvious choice if there is no other source of funds. In such cases, the opportunity costs are clear, even if the consumer does not know the academic concept.

Because payday borrowers have checking accounts, they could risk using checks that could arrive at the bank before they can receive their next paycheck. According to Bankrate.com, in 2009 the average Non-sufficient Funds (NSF) fee was approximately \$30. Given that this is the average, it is clear that some banks charge more than \$30. Currently, federal law does not limit how much a nationally chartered bank can charge for NSF fees. If this involves more than one check submitted during the period in question, the fees could easily exceed the \$45 charge on a \$300 payday loan. Some banks charge progressively higher NSF charges with each returned check or may even close the account for too many returned checks.

A returned check on a credit card payment may generate two fees from the credit card company, a late payment fee and a returned check fee, in addition to the bank's NSF fees. In 2009, Bankrate.com reported that the average credit card late fee was \$39. Most credit card companies charge a fee if a check is returned to them for insufficient funds. Even worse, these fees are added to the balance and incur additional interest charges until it is paid off, adding even more debt. The NSF fee, late payment fee and the fee the credit card company charges for the returned check will easily exceed the \$45 payday loan fee.

Of course, a consumer may chose to not make payments on time rather than incur the bank NSF fees. This may lead to a series of late fees from credit cards (\$39), utilities/reconnection (amount depends on the locality), telephone/reconnection (amount depends on service provider) and incur negative credit histories. As noted previously, it could also lead to the loss of an apartment, car or house.

The combination of NSF and other late fees has the potential to cascade into a crisis. These multiple fees can easily climb to several hundred dollars within the space of a few days. For consumers, the rational choice, a \$45 fee which is comparable to a 15% charge, is greatly preferable to the alternative of several hundred dollars in other fees, absent the availability of a payday loan. While the industry and its critics make interest rate comparisons between payday loans and late/reconnection fees (credit card, rent, NSF, utility fees), those comparisons are

⁴⁰ Elliehausen & Lawrence (2001)

largely lost on the consumers who depend on the availability of such credit. Those comparisons lose sight of how these consumers make their choices.

IMPACT OF PROPOSED CHANGES

Given the choices Hispanics face in deciding whether to apply for a payday loan, any changes to the availability of this source of credit will impact the Hispanic community. Whether the changes limit lending opportunities, change fees or eliminate the industry, policy changes have the potential to negatively or positively impact Hispanic families.

In the market, competition among payday lenders has proven an effective way to lower fees. As more companies enter the market, fees have gone down. As more information is available about the lenders' fees and charges, potential borrowers are able to seek out the best loan options⁴¹.

The research indicates that the extreme policy of outlawing payday lending has had the most adverse impact on Hispanics and other low-income borrowers. For example, in Oregon, borrowers were "significantly more likely to experience an adverse change in financial condition" after payday loans were prohibited in the state. The research indicated that limiting credit access for consumers "hinders productive investment and/or consumption smoothing, at least over the short term." Although the elimination of payday lending closed one option for consumers, it did not provide viable alternative sources for credit. As a result, consumer opportunity costs are increased. Given the option of not making certain payments/purchases, consumers are faced with the prospect of seeking out even more costly credit sources, even possibly illegal sources⁴².

Capping fees, as noted previously, would help consumers, as long as it does not result in a limiting of access to credit. However, the more effective way to limit or reduce fees is to increase competition. As noted previously, an increase in the number of companies offering payday loans in a given neighborhood is more likely to lead to lower fees while giving consumers greater options, lowering their opportunity costs as well as the out-of-pocket costs⁴³.

The legislated capping of fees may actually lead to companies leaving the market, further reducing options for consumers. For Hispanics, this is a critical challenge because of language barriers. With fewer companies providing these services, there would be fewer branches located within predominantly Hispanic neighborhoods, where there would be a greater likelihood that employees speak Spanish. Otherwise, many non-English speaking Hispanics may not have access to such services.

⁴¹ Elliehausen & Lawrence (2001)

⁴² Zinman, J. (2008). Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap. Dartmouth College

⁴³ Donald P. Morgan, D. P., & Strain, M. R. (2008). Payday Holiday: How Households Fare after Payday Credit Bans. *Federal Reserve Bank of New York Staff Reports*, no. 309, revised February 2008

It seems clear that the push for further regulation of payday lending services will continue. However, for Hispanics and Hispanic communities, it is essential that it should result in increased opportunities for credit sources.

Access to credit remains one of the essential economic elements of any successful community, including personal, commercial and community development credit. For the Hispanic community, having access to credit sources, whether it is for personal use or otherwise, will be vital to its future growth and development. Regulator or legislative changes must provide for continuing access to appropriate credit sources for this growing community.