Southwest Public Policy Institute

NO. 2 | FEBRUARY 2023
CENTER FOR FINANCIAL RESPONSIBILITY

No Loan for You!

Why the War on Specialized Emergency Loans Hurts New Mexico

D. Dowd Muska & Patrick M. Brenner

Half of the harm that is done in this world
Is due to people who want to feel important.
They don't mean to do harm – but the harm does not interest them.
Or they do not see it, or they justify it
Because they are absorbed in the endless struggle
To think well of themselves.

– T. S. Eliot, *The Cocktail Party* (1949)

This paper, in its entirety, can be found at **https://southwestpolicy.com/sppi02**

855.411.7774 | southwestpolicy.com | info@southwestpolicy.com
PO Box 1746 | Bernalillo, New Mexico 87004

Southwest Public Policy Institute | *Better living through better policy*

SOUTHWEST PUBLIC POLICY INSTITUTE

The Southwest Public Policy Institute (SPPI) is a research institute built to explore and build on sound, data-driven policies regarding education, crime, and economics that will encourage positive change in the American Southwest.

Many think tanks have fallen victim to the mentality of communicating only to the echo chamber: they only target individuals that agree with partisan messaging. SPPI's approach enables us to reach new audiences by micro-targeting constituents on issues like finance, energy, education, or public safety.

With SPPI's data-first approach and the inclusion of every state in the American Southwest in our efforts, there is tremendous potential for reinvigorating traditional American values with one motto: WE AGREE. By removing the stigma from conversations with constituents and addressing issues with solutions to solve problems, we truly believe that we can help move the American Southwest in a positive direction and set an example for the entire region to follow.

Our focus includes fostering innovative policy alternatives at the regional, state, and community levels to enhance individual initiative and entrepreneurship, broadening the role of volunteerism in confronting public problems and the sense of community among the public, government, and business.

The division in America comes from the unwillingness to communicate with one another and to discuss the problems and the issues in front of us. By working together, exchanging ideas, and bringing solutions to problems we face, we can accomplish what public servants are meant to do: deliver ***better living through better policy***.

INTRODUCTION

Imagine you are a married father of three. You own a home and make your mortgage payments on time. Your work history is solid, your credit scores are stellar (over 800), and you have no criminal record. By every measure, you are a well-qualified prospective borrower.

The scenario is not a fantasy for one of us (Patrick M. Brenner), who recently attempted to obtain a short-term, small-dollar loan from three national banks in the Albuquerque, New Mexico metropolitan area. His experience exposed an unpleasant reality that should disturb all who care about the customers and providers of financial services in the Land of Enchantment.

Last month, The Pew Charitable Trusts claimed that "five years ago, no large banks offered small installment loans or lines of credit to checking account customers with low or no credit scores." But today, "six of the eight largest banks, measured by their number of branches, do."[1]

After reading about "the new availability of bank small-dollar loans," Patrick was curious. Of the financial institutions Pew listed, three have branches in New Mexico: U.S. Bank, Wells Fargo, Bank of America. Over the course of a week, Patrick applied for a small-dollar loan at each of the financial institutions. His experiences were far from "consumer-friendly."

For U.S. Bank, the process started easily enough: Patrick strolled into the lobby of a local branch and asked about a "Simple Loan." The tellers didn't understand his query and requested a manager, despite Patrick using U.S. Bank's own name for the product.

"We don't offer these loans in branch," said the manager. "You'll need to apply online."

"But I don't have an account with online banking access," stated Patrick.

"Then you'll need to open a checking account."

Patrick did as told – supplying a $25 minimum to open a checking account, and agreeing to fees of about $5 per month. (An ATM was needed to withdraw the requisite cash.)

Patrick returned with the cash, and once the checking account was established – after a relatively simple application – online banking was set up. From there, applying for the loan was smooth.

Patrick leaves U.S. Bank without a specialized emergency loan.

The entire process, from entering the lobby until receiving the rejection notice, took about three hours, including transit time. Unfortunately, the application was denied.

The same procedure took place at Bank of America. Denial, again, was the result – after the same amount of time was wasted and the same amount of cash was lost. Now Patrick was down $50, and still didn't have access to the small loan he "needed."

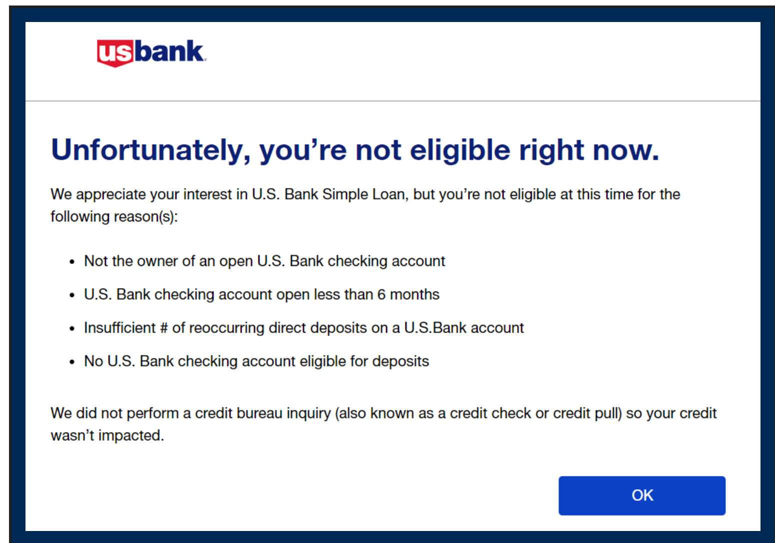
Patrick needed a checking account to borrow from Wells Fargo, too. But after his first visit to a local branch, it was determined that an appointment was necessary. The earliest opportunity was 10:00 am the following morning.

Patrick arrived promptly at 9:55, but 10:00 am came and went, as other walk-in customers took up positions with the available bankers. Patrick was not seen until about 10:15 am. After a similarly lengthy process, Patrick finally left the branch with his new checking account, short by another $25. From there, the online application for the loan was rejected, again. Wells Fargo took over four hours of time, including transit to and from the branch, twice, as well as the delays in meeting the appointment time by the branch employees.

After visiting these three branches, it became clear: the lauded "consumer-friendly

small-dollar loan products" offered by the big banks were anything but consumer-friendly. In the end, no small-dollar loan was offered.

To reiterate, Patrick is solidly middle class, with an excellent financial history and not so much as an outstanding parking ticket. He and his wife have access to revolving credit from numerous institutions, and their accounts are all in good standing.



Patrick was deemed ineligible for a U.S. Bank "Simple Loan".

So why was Patrick denied access to a small-dollar loan – *three times*?

'PAYDAY LOANS': JUST THE FACTS

The Federal Deposit Insurance Corporation defines the "unbanked" as those who "do not have an account at a federally insured depository institution," and the "underbanked" are those who "have an account and also use nonbank products or services that are disproportionately used by unbanked households to meet their transaction and credit needs."[2]

There are several reasons why Americans are unbanked/underbanked. For some, the expense of "maintaining a bank account, including meeting minimum balance requirements and paying fees for overdrafts and other services," is too burdensome. Others have a "lack of trust in banks," and some have a passionate "desire for privacy."[3]

In Albuquerque, New Mexico's largest city, "a third of the households … do little or no mainstream banking, substantially higher than the national average."[4]

Fortunately, alternative financial services (AFS) exist to meet the needs of the unbanked/underbanked. Options include "[c]heck-cashing outlets, money transmitters, car title lenders … pawnshops, and rent-to-own stores."[5] The AFS

marketplace includes what critics deride as "payday loans." Whatever one calls them, they

> *provide fast cash to cover emergency situations or help pay a borrower's expenses from one paycheck to the next. These unsecured loans have a short repayment period . . . . A balloon payment – full amount of the loan plus fees – is generally due on the borrower's next payday after the loan is made.*
>
> *The loans are generally for $500 or less and come due within two to four weeks after receiving the loan. Loan lengths vary based on the borrower's pay schedule or how often income is received – so the length could be for one week, two weeks, or one month.*[6]

Borrowers "tend to be relatively young and earn less than $40,000; they tend to not have a four-year college degree; and while the most common borrower is a white female, the rate of borrowing is highest among minorities."[7] As the Competitive Enterprise Institute noted, for the unbanked/underbanked, "a car breaking down or the need for emergency travel" can impose an obstacle that would not concern most middle- and upper-income households. And for people at the lower end of the socioeconomic scale "who could pay back [a small-dollar] loan in a few months, or even a few weeks," the "options are limited":

> *A bank typically won't process a consumer loan of a few hundred dollars. Sometimes folks in a pinch can borrow money from relatives, but even when they can, for many this is a blow to their pride.*
>
> *These individuals can also be late in paying their bills and credit card debt, bounce a check, or overdraw on their debit card. But these options not only result in lowering their credit scores, which affect their ability to better their lives through a new job or starting a business, they are often more costly than a payday loan would be.*[8]

It's little wonder, then, that from close to zero just three decades ago, millions of Americans now conduct business with the short-term, small-dollar credit industry every year. And these types of loans are increasingly moving online. Clarity Services, the "leading credit reporting agency for near-prime and nonprime consumers," found that between 2016 and 2019, the volume of "online single pay loans" more than doubled.[9]

MISSING THE POINT – AND THE PURPOSE

In 1998, the Consumer Federation of America contended that "[payday] loans sanction the writing of bad checks and entice consumers into relying on very expensive debt to live beyond their means."[10] It was one of the earliest attacks on an industry that deep-pocketed activists and media-savvy politicians on both the left and right label "predatory."

In 2010, President Obama touted the federal government's new Consumer Finance Protection Bureau (CFPB) as having "the potential to save consumers billions of dollars over the next 20 to 30 years," via "simple stuff," including "making sure that payday loans aren't preying on poor people in ways that these folks don't understand."[11] In 2019, the cable-news commentator Tucker Carlson thundered: "Why is it defensible to loan people money they can't possibly repay? Or charge them interest that impoverishes them? Payday loan outlets in poor neighborhoods collect 400 percent annual interest."[12]

When exploring the reality of short-term, small-dollar credit, Carlson's accusation is the best place to begin. The industry's enemies monotonously maintain that it imposes excessively high "interest rates" on borrowers. But as a Cato Institute scholar observed, calculating an annual percentage rate (APR) for the type of loans Carlson denounced requires "a little bit of hocus-pocus."[13] Customers typically pay a flat fee for borrowing, and by their very nature, the loans are of very limited length:

> *[F]ew, if any, borrowers take a whole year to pay off their payday loans. Data suggest most borrowers pay back the initial amount borrowed within six weeks, so it is highly unlikely that most borrowers would end up paying anywhere near the purported APR of the loan.*[14]

Economist Thomas Sowell exposed the fallaciousness of the APR artifice with two helpful analogies:

> *Using this kind of reasoning – or lack of reasoning – you could quote the price of salmon as $15,000 a ton or say a hotel room rents for $36,000 a year, when no consumer buys a ton of salmon and few people stay in a hotel room all year. It is clever propaganda.*[15]

As for Obama's insinuation that borrowers are too stupid to know what they're doing,

payday loans enjoy widespread support among their users. Surveys have found that 95 percent of borrowers say they value having the option to take out a payday loan. The same proportion also believe that payday loans provide a safety net during unexpected financial trouble. A 2009 comprehensive economic analysis of consumer demand for payday loans by George Washington University Economics Professor Gregory Elliehausen … found that 88 percent of respondents were satisfied with their last transaction. Less than 2 percent of the consumer complaints filed with the CFPB are related to payday loans, with the vast majority related to already illegal collection practices.

…

Small-dollar lenders are often more competitive on price and accessibility than traditional banks. Some customers prefer payday lenders because they are more transparent and provide better service. Rather than being hit with an unexpected overdraft fee, customers appreciate the transparency of a flat, predictable fee. Storefront payday lenders also foster personal relationships between the teller and the customer. Professor Lisa Servon … worked as a check casher and small-dollar loan teller. She found that many customers felt they got better service than at banks. According to Servon, not a single person she served complained about being charged too much or about quality of the products, or got into an argument with their teller. She and her colleagues were repeatedly tipped by their customers who appreciated the service.[16]

Finally, while opponents of short-term, small-dollar credit assert that the industry operates in a "Wild West" environment bereft of government scrutiny, that is not the case:

Payday lending is highly regulated at the state level – including through usury limits, maximum loan amounts, and proscribed collection practices – and is subject to existing federal laws covering consumer credit generally, such as the Truth in Lending Act, Equal Credit Opportunity Act, Electronic Funds Transfer Act, and the Gramm-Leach-Bliley Act.[17]

'HELPING' BY HURTING

Despite their vacuous claims, crusades against "payday loans" have proven successful in several states. A 36 percent "APR" cap, enacted via legislation on ballot initiative, is often the goal. Such a mandate was adopted by South Dakota in 2016, Colorado in 2018, California in 2019, and Nebraska in 2020.

Ironically, as the "consumer protection" has intensified, research undercutting its justifications has grown. In 2016, an investigation published by The Journal of Law and Economics concluded that "consumers switch to other forms of high-interest credit when payday loans become unavailable."[18] The following year, a professor at the University of Idaho found that Ohio's "attempt to eliminate hardships caused by payday loan usage through prohibition ... may have inadvertently shifted the problem from one industry to another" – i.e., with "payday loans" curtailed, "consumers will seek alternatives and substitute across other financial service products, such as pawnbrokers, over-draft fees, and direct deposit advances."[19]

Clearly, "banning or limiting payday lending doesn't alter the underlying reasons why people seek out such loans. Restricting payday loans pushes users to other options, which have tradeoffs of their own."[20]

A few months ago, a study of Illinois's cap on the "interest rate" for specialized emergency credit discovered that the restriction "decreased the number of loans to subprime borrowers by 44 percent and increased the average loan size to subprime borrowers by 40 percent." Furthermore, "an online survey of short-term, small-dollar borrowers in Illinois" found that "only 11 percent of the respondents answered that their financial well-being increased following the interest-rate cap, and 79 percent answered that they wanted the option to return to their previous lender."[21]

Last month, data released by Colorado's attorney general "confirmed previous studies' findings that interest rate caps reduce access to credit for consumers who need it," with "small dollar loans … less available for nonprime consumers in Colorado than in Utah or Missouri, states with fewer restrictions on small dollar lending."[22]

At the federal level, it is worth noting the impact of 2006's Military Lending Act (MLA), which

> *imposed a 36 percent interest rate cap on consumer credit for active-duty service members and their dependents.*
>
> *Research … shows that the legislation has offered no benefit to members of the military and their families, and may even have caused some harm. In 2017, researchers at the U.S. Military Academy at West Point found that payday lending has had no adverse effects on members of the military and that the MLA was unnecessary. Further, since the MLA was enacted,*

the number of financial services companies operating near military bases and serving military families has dropped. This has contributed to the high number of military personnel suffering from financial distress, which more than doubled between 2014 and 2019.[23]

NEW MEXICO SUCCUMBS

The Land of Enchantment suffers from the fourth-lowest median household income in the nation.[24] It "has long had some of the highest rates of alcohol and drug abuse."[25] The share of all state births to unwed mothers is third-worst.[26] And the portion of its young-adult population that has dropped out of high school is the largest in America.[27]

Given its profound socioeconomic pathologies – and "progressive" politics – New Mexico is fertile ground for the war on specialized emergency lenders. In 2005, then-Governor Bill Richardson, making vague assertions about "just a lot of abuses and problems in the state," proposed "a reasonable cap."[28] But the industry's defenders managed to forestall additional regulations for many years, despite a withering onslaught of criticism from city councils, county commissions, religious organizations, liberal lobbyists, taxpayer-financed academics, and a highly sympathetic (and at times, wildly biased) news media. (Dissenting voices were all but nonexistent, although in 2015, the *Clovis News Journal*'s editorial page gamely declared that it is "simply not government's place to interfere with the free market."[29])

In 2017, legislation was passed barring any "lender, other than a federally insured depository institution" from making a loan "that has an annual percentage rate … greater than 175%."[30] Then-Governor Susana Martinez signed the bill into law.

But 175 percent is not 36 percent, and the specialized emergency lending industry was far from safe. In 2020, efforts to tighten the cap strengthened, when a leftist "results-oriented think tank" launched its "End Predatory Lending" initiative. Two years later, Think New Mexico "successfully advocated for the passage of House Bill 132 … to reduce the maximum annual interest rate on small loans from 175% to 36%."[31] Enthusiastically signed into law by current Governor Michelle Lujan Grisham – in 2021, she had made ending "predatory lending practices by limiting annual interest rates and increasing maximum loan size" a legislative priority[32] – the 40-page legislation became effective on January 1, 2023.[33]

As the new year approached, the *Santa Fe New Mexican* reported that the law

was “already changing the face of the state’s small-lending industry.” The New Mexico Regulation and Licensing Department disclosed that “the number of active licenses for small-loan companies has dropped 7.5 percent in recent months, from 452 in June to 418 in November, and employees in the industry say numerous lenders have closed up shop.”[34] Three weeks later, the *Albuquerque Journal* reported that the “‘buy now, pay later’ service Afterpay” would “no longer be doing business in the state,” because of what the company called “regulatory changes.”[35]

As the options for AFS dwindle in the Land of Enchantment, are other players in the financial-services industry stepping up? The Pew Charitable Trusts – based in Philadelphia – boasts about the growing availability of “safer and more affordable” options “for customers who previously would turn to high-cost payday loans or other alternative financial services, such as auto-title loans and rent-to-own agreements.”[36] Santa Fe New Mexican columnist Milan Simonich – conducting no research of his own – makes the same gauzy assertion, writing that “banks are providing small loans to New Mexico customers at reasonable rates, all at a rapid clip.”[37] Patrick certainly didn’t find that to be the case with the three Albuquerque-area banks he tested.

CONCLUSION

Feel-good public policy often has the opposite effect of what its backers seek to accomplish. Even at this early stage of the 36 percent “APR” cap, the Law of Unintended Consequences appears to be at work in New Mexico. The “successful” campaign against “payday loans” has been a dubious blessing for the state’s unbanked/underbanked. Rest assured, additional government interventions will be proposed to “solve” the problems created by well-intentioned but fundamentally ignorant activists and politicians.

Policymakers in the Land of Enchantment should replace virtue-signaling regulation with “rules of the road” that foster greater competition in financial services. Clear, consistently enforced standards can ensure that the lending market is open to all providers, while at the same time protect consumers. To truly aid the state’s middle- and low-income households, the goal should be increased choice, not the inhibition of nontraditional credit options. Ideology and optics are no substitute for a healthy marketplace.

NOTES

1 Alex Horowitz and Gabriel Kravitz, "Six of The Eight Largest Banks Now Offer Affordable Small Loans," The Pew Charitable Trusts, 24 January 2023.
2 *2021 FDIC National Survey of Unbanked and Underbanked Households*, Federal Deposit Insurance Corporation, October 2022.
3 Paola Boel and Peter Zimmerman, "Unbanked in America: A Review of the Literature," *Economic Commentary*, Federal Reserve Bank of Cleveland, 26 May 2022.
4 Richard Metcalf, "'Unbanking' fuels financial fallout," *Albuquerque Journal*, 07 September 2015.
5 "Alternative Financial Services: A Primer," *FDIC Quarterly*, Volume 3, Number 1, 2009.
6 Jeannette N. Bennett, "Fast Cash and Payday Loans," *Page One Economics*, Federal Reserve Bank of St. Louis, April 2019.
7 Robert DeYoung (University of Kansas), *Freakonomics Podcast*, Episode 241, 06 April 2016.
8 John Berlau, "H.R. 1909 Brings Competitive Regulation to Small Loan Market," Competitive Enterprise Institute (blog), 13 September 2011.
9 *2021 Alternative Financial Services Lending Trends*, Clarity Services, April 2021.
10 Jean Ann Fox, "The Growth of Legal Loan Sharking: A Report on the Payday Loan Industry," Consumer Federation of America, November 1998.
11 "Obama in Command: The Rolling Stone Interview," *Rolling Stone*, 15 October 2010.
12 Tucker Carlson, opening monologue, *Tucker Carlson Tonight*, Fox News Channel, 02 January 2019.
13 Thaya Brook Knight, "Feds Will Regulate Payday Lenders," *Cato Daily Podcast*, Cato Institute, 15 April 2016.
14 Matthew Adams and John Berlau, "The Annual Percentage Rate Is the Wrong Metric for Assessing the Cost of a Short-Term Loan," *OnPOINT* No. 268, Competitive Enterprise Institute, 07 April 2021.
15 Thomas Sowell (Creators Syndicate), "Basic payday loans economics," *The Orange County Register*, 02 November 2011.
16 Daniel Press, "How the Consumer Financial Protection Bureau's Payday Loan Rule Hurts the Working Poor," *OnPOINT* No. 241, Competitive Enterprise Institute, 17 January 2018.
17 Hilary Miller, "Ending Payday Lending Would Harm Consumers," *OnPOINT* No. 220, Competitive Enterprise Institute, 05 October 2016.
18 Niel Bhutta, Jacob Goldin, and Tatiana Homonoff, "Consumer Borrowing after Payday Loan Bans," *Journal of Law and Economics*, Vol. 59, No. 1, February 2016.
19 Stefanie Ramirez, "Payday-Loan Bans: Evidence on Indirect Effects on Supply," University of Idaho, 21 July 2017.
20 Timothy Taylor, *The Conversable Economist* (blog), 06 July 2011.
21 J. Brandon Bolen, Gregory Elliehausen, and Thomas W. Miller, Jr., "Effects of Illinois' 36% Interest Rate Cap on Small-Dollar Credit Availability and Financial Well-Being," 29 December 2022.
22 Liz Jones (statement), Online Lenders Alliance, "Colorado Consumer Lending Study Confirms That Rate Caps Reduce Credit Options For Consumers And Fail To Improve Consumers' Wellbeing," 25 January 2023.
23 Matthew Adams and John Berlau, "The Annual Percentage Rate Is the Wrong Metric for Assessing the Cost of a Short-Term Loan," *OnPOINT* No. 268, Competitive Enterprise Institute, 07 April 2021.
24 "Real Median Household Income by State, Annual," Federal Reserve Economic Data, Federal Reserve Bank of St. Louis, accessed 10 February 2023.
25 "Substance Use Disorder Treatment and Outcomes in New Mexico," *Health Notes*, Program Evaluation Unit, Legislative Finance Committee, New Mexico Legislature, November 20, 2019.
26 "Percent of Babies Born to Unmarried Mothers by State," National Center for Health Statistics, Centers for Disease Control and Protection, accessed 10 February 2023.
27 "Percentage of high school dropouts among persons 16 to 24 years old (status dropout rate), by race/ethnicity and state: 2019," Table 219.85a, *Digest of Education Statistics*, U.S. Department of Education, 2020.
28 Andy Lenderman, "Gov. To Propose Payday Loan Cap," *Albuquerque Journal*, 14 February 2005.
29 "Government has no place in free market" (editorial), *Clovis News Journal*, 19 February 2015.

30 HB 347 Fiscal Impact Report, Legislative Finance Committee, New Mexico Legislature, last updated 17 March 2017.
31 "End Predatory Lending," Think New Mexico website, undated, accessed 12 February 2023.
32 "Gov. Lujan Grisham priorities for 2021 session: Sustaining key investments, regaining economic momentum," press release, 13 January 2021.
33 HB 132 Fiscal Impact Report, Legislative Finance Committee, New Mexico Legislature, last updated 16 February 2022.
34 Daniel J. Chacón, "New law slashing interest rate cap shakes up state's small-loan industry," *Santa Fe New Mexican*, 10 December 2022.
35 Alaina Mencinger, "'Buy now, pay later' company Afterpay quits in New Mexico," *Albuquerque Journal*, 31 December 2022.
36 Alex Horowitz and Gabriel Kravitz, "Six of The Eight Largest Banks Now Offer Affordable Small Loans," The Pew Charitable Trusts, 24 January 2023.
37 Milan Simonich, "Big banks step up to silence storefront lending fearmongers," *Santa Fe New Mexican*, 21 February 2023.