



## WHY CREDIT SCORES AND PAYDAY LENDING MATTER FOR HEALTH

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### INTRODUCTION

In the United States, credit score and payday lending systems have significant implications for public health and racial equity. In 2018, health researchers showed for the first time that using payday loans was associated with poor health, adding to a well-established literature on over-indebtedness and adverse physical and mental health. In this paper, I examine the emerging evidence of connections between access to personal credit and health in the United States and employ systems theory to categorize solutions into incremental, reform-level, and transformational changes. Finally, I provide suggestions for further research related to credit and health for multiple health and community development stakeholders. As household debt in the United States has grown substantially over the last 20 years and continues to grow, more focus on the connections between the financial system, predatory loans and health is needed to better understand how social and economic systems contribute to individual and community health.

### THE CONNECTIONS BETWEEN LOANS AND SOCIAL DETERMINANTS OF HEALTH

Access to low-interest personal credit is essential for individual and community well-being in the US. Public health practice is concerned with how health care services and the general features of a person's life contribute to health and well-being. These general features are termed

“social determinants” of health or of equity. Social determinants of health have been shown to constitute 80% of what improves health, compared to health care services which contribute 10 to 15%.<sup>1</sup> The National Academies of Sciences, Engineering and Medicine define social determinants of health as education, employment, health systems and services, housing, income and wealth, physical environment, public safety, social environment, and transportation.<sup>2</sup> People with no credit score face challenges when seeking loans to secure social determinants, such as education, employment and opportunities to generate income, health services, housing, and transportation. Applying a racial equity lens, 19% of American adults (45 million) lack credit scores, representing 28% of all Black and Latinx adults and 14% of White adults. The consequences of having no credit score are more likely to be borne by people of color than by White people, although millions of White people face similar constraints, especially those living in rural places. See Appendix A for more detail about the income, race/ethnicity, and urban/rural locations of those with no credit scores.

People without credit scores also are more likely to use alternative financial services credit, including payday loans and similar high interest credit arrangements, since they cannot easily obtain lower-interest credit cards for short-term personal loans. Alternative financial services loans

<sup>1</sup> J. Michael McGinnis, Pamela Williams-Russo, and James R. Knickman, “The Case for More Active Policy Attention to Health Promotion,” *Health Affairs* 21, no. 2 (March/April 2002): 78-93, <https://doi.org/10.1377/hlthaff.21.2.78>.

<sup>2</sup> National Academies of Sciences, Engineering, and Medicine, *Communities in Action: Pathways to Health Equity*. (Washington, DC: The National Academies Press, 2017), 5. <https://doi.org/10.17226/24624>.

*The views expressed are those of the author and do not necessarily represent the Federal Reserve Bank of San Francisco or the Federal Reserve System.*



are characterized by being unsecured, having high interest rates ranging from 100% to 677% or higher annual percentage interest rates (APR), and having short payback periods (such as two weeks) of single or multiple principal installments. Six out of seven users of payday loans (85%) cannot pay back their principal on time and instead pay interest in the form of fees every two weeks or every month for several months.<sup>3</sup> See Appendix B for more information about the income, race/ethnicity and urban/rural locations of those who use payday loans and why the loans are sought.

One-third to one-quarter of American adults without credit scores use payday loans. Similar to those lacking credit scores, payday loan users are more likely to have lower incomes, be people of color, and live in urban and rural areas versus suburban locations. Slightly more than half of those using payday loans are women (52%) and people with disabilities are twice as likely as the general population to use payday loans (12% versus 6%).<sup>4</sup>

The connections between payday and similar high cost loans and health are relevant for many stakeholders, including place-based initiative staff, health care providers, Medicaid Directors, public health officials, health researchers, economists, and community developers. Further research is needed, soon, to better understand and act to reduce exposure to high interest loans due to their recent spread, their influence on health and the role they play in limiting access to the social determinants of health.

## RESEARCH ON DEBT AND HEALTH

The associations between over-indebtedness and adverse effects on health are well documented.<sup>5</sup> Studies have

<sup>3</sup> Consumer Financial Protection Bureau, *Data Point: Payday Lending*, (March 2014): 26, [https://files.consumerfinance.gov/f/201403\\_cfpb\\_report\\_payday-lending.pdf](https://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf).

<sup>4</sup> Pew Charitable Trusts, *Payday Lending in America: Who Borrows, Where They Borrow, and Why*, (July 2012), 35, [https://www.pewtrusts.org/-/media/legacy/uploadedfiles/pew\\_assets/2012/pewpaydaylendingreportpdf.pdf](https://www.pewtrusts.org/-/media/legacy/uploadedfiles/pew_assets/2012/pewpaydaylendingreportpdf.pdf).

<sup>5</sup> Elina Turunen and Heikki Hiilamo, "Health Effects of Indebtedness: A Systematic Review" *BioMed Central Public Health* 14 (2014): 489, <http://www.biomedcentral.com/1471-2458/14/489>; Chris Fitch, Sarah

**Public health lens:** A public health lens analyzes the percentage of a population with a particular disease or risk factor to understand why some are more likely to suffer from poor health than others.<sup>1</sup> A public health lens is used here to analyze population-wide relationships between access to low-interest personal credit and individual and community well-being. Public health is a field rooted in social justice that routinely uses a racial equity lens in its health promotion and protection work.<sup>2</sup>

**Racial equity lens:** A racial equity lens disaggregates data by race and ethnic categories and takes systems and history into account to better understand trends and the fairness of factors contributing to well-being. While race is a socially constructed concept, it is important to study because it carries real consequences, including access to financial resources, for people's daily life today and in the past.<sup>3</sup>

<sup>1</sup> "What is Public Health?" American Public Health Association, accessed January 24, 2019, <https://www.apha.org/what-is-public-health>.

<sup>2</sup> "Health Equity," American Public Health Association, accessed January 24, 2019, <https://www.apha.org/topics-and-issues/health-equity>.

<sup>3</sup> Annie E. Casey Foundation, *Grant Making with a Racial Equity Lens*, May 2007, <https://www.aecf.org/resources/grant-making-with-a-racial-equity-lens>.

found links between debt and measures of poor health, including lower life expectancy; high blood pressure; obesity; foregone medical treatment and medications; poor self-reported health; depression, anxiety and other mental disorders; and child behavior problems.<sup>6</sup> The

Hamilton, Paul Bassett, and Ryan Davey, "The Relationship between Personal Debt and Mental Health: A Systematic Review." *Mental Health Review Journal* 16, no. 4 (2011): 153–66, <https://doi.org/10.1108/13619321111202313>; and Elizabeth Sweet, Arijit Nandi, Emma K. Adam, and Thomas W. McDade, "The High Price of Debt: Household Financial Debt and its Impact on Mental and Physical Health," *Social Science & Medicine* 91, (August 2013): 94–100, <https://doi.org/10.1016/j.socscimed.2013.05.009>.

<sup>6</sup> Elizabeth Sweet, Christopher W. Kuzawa, and Thomas W. McDade, "Short-term Lending: Payday Loans as Risk Factors for Anxiety, Inflammation and Poor Health." *Social Science & Medicine—Population Health* 5, (2018): 114, <https://doi.org/10.1016/j.ssmph.2018.05.009>.



research distinguishes between different types of debt and health associations. Some debt can be beneficial to well-being such as securing stable housing through an affordable mortgage.<sup>7</sup> The health effects of using alternative financial services loans specifically have been studied recently and are documented in two 2018 epidemiologic studies.

### ***A matched comparison group study found lower reported health status among payday loan users***

The first published empirical analysis of the association between payday lending and health was released in March 2018.<sup>8</sup> Researchers from the University of Washington used records from the Census and Bureau of Labor Statistics from 2011 to 2016 to compare 589 payday, pawn, and car title loan users with a matched group of 1,472 non-users. The researchers hypothesized that payday lending would be associated with poor health because high interest and fees may increase financial hardship and because of the stress from excessive debt and financial instability. This study design controlled for confounding variables, including age, income, education, gender, employment status, race/ethnicity, foreign birth, veteran status, health insurance, food stamps, unbanked status, urban or rural, state of residence, and year. To address reverse causation (whether respondents used payday loans because they had poor health), the researchers ran one version of their analysis excluding respondents who reported poor health in the early years of the study. Respondents who received disability benefit income or were uninsured also were excluded.

These researchers found that payday loan use in the past year was associated with 38% higher prevalence of poor or fair health compared to the comparison group. The model modifications that tested for reverse causation did not change their findings. Reporting poor or fair health versus good or excellent health is associated with higher

hospitalization rates and higher health care costs in many populations, including those with Medicaid coverage.<sup>9</sup>

The authors considered whether regulatory changes would be enough to protect the population's health from payday and similar lenders. They concluded that regulations, including limiting interest rates charged by payday lenders or requiring mainstream banks to offer affordable services, would likely not alone lead to improved financial well-being and health. They recommended that alternative banking arrangements such as lending circles, a US Postal Service bank, municipal banks and low-interest mobile banking options be explored. The researchers believed that reducing financial instability would reduce demand for payday loans and that public health care, housing and disability assistance, along with raising wages and labor protections would address root causes and lower demand. They cited research showing that policies like a Medicaid expansion and a minimum wage increase have been associated with reductions in payday borrowing. They added that reducing segregation and mass incarceration also would likely reduce payday lending and improve health equity.

### ***An in-depth study of payday loan users found biomarker risk factors and poor self-reported health more likely than among a comparison group***

The second epidemiologic study of payday loans was published in October 2018 by University of Massachusetts Boston and Northwestern University researchers.<sup>10</sup> They conducted interviews and collected biomarker data from 286 people. Biomarker data included weight, blood samples and blood pressure measurements. The study examined the biological mechanisms involved in the stress of living in a debt trap and found associations with cardiovascular disease and metabolic risk. Specifically, payday loan use was associated with higher blood pressure, body mass index, waist circumference, and C-

<sup>7</sup> Sweet, Kuzawa and McDade, "Short-term Lending," 115.

<sup>8</sup> Jerzy Eisenberg-Guyot, Caislin Firth, Marieka Klawitter, and Anjum Hajat, "From Payday Loans to Pawnshops: Fringe Banking, the Unbanked, and Health," *Health Affairs* 37, no. 3 (March 2018): 429–37, <https://doi.org/10.1377/hlthaff.2017.1219>.

<sup>9</sup> Karen J. Blumenthal, Yuchiao Chang, Timothy G. Ferris, Jenna C. Spirt, Christine Vogeli, Neil Wagle, and Joshua P. Metlay, "Using a Self-Reported Global Health Measure to Identify Patients at High Risk for

Future Healthcare Utilization," *Journal of General Internal Medicine* 32, no. 8, (August 2017): 877-882, <https://doi.org/10.1007/s11606-017-4041-y>; and John A. Fleishman, Joel W. Cohen, Willard G. Manning, and Mark Kosinski, "Using the SF-12 Health Status Measure to Improve Predictions of Medical Expenditures," *Medical Care*, 44, no. 5 (May 2006): 54, <https://doi.org/10.1097/01.mlr.0000208141.02083.86>.

<sup>10</sup> Sweet, Kuzawa and McDade, "Short-term Lending," 114-121.



reactive protein levels (an inflammatory marker) compared with the level of these indicators among a group of non-users. The differences in body mass index and waist circumference were substantial, similar to or larger than what is typically observed in differences by income and race. The researchers also discovered higher levels of self-reported symptoms of adverse physical and mental health after controlling for demographic covariates, including age, race and welfare receipt. They warned that short-term loans with high interest rates should be considered a specific risk to population health.

### **Focus group and interview quotes describe health consequences of payday loan use**

Qualitative research provides more information about how payday loans affect borrowers' health.<sup>11</sup> In a study of 128 payday loan users, interviewees described intense feelings of stress, depression, and emotional and physical suffering associated with paying high interest and doing without other necessities. They reported "feeling bogged down," "at times I have felt really burdened by debt and life and I ended up struggling with depression," "locked in...stifled...like I can't get out," "like I'm on a treadmill," "in a sinkhole...quicksand" and "drowning in debt." Several reported how their debt caused them to eat only once or twice a day, go without new shoes or clothes, or wear dirty clothes instead of paying for laundry.

A borrower in another study said: "Every two weeks I was just paying interest. And I think I got frustrated with it because knowing that the interest you're paying really isn't even close to what you took, and by the time you know it, you paid more than what you took from them...It eats you

up, really, and it's very stressful to deal with that—not knowing where you're going to live next, or how you're going to come up with your rent."<sup>12</sup>

### **Payday lending stores are located in the types of places where people without credit scores live**

Public health is interested in both individuals' health as well as the characteristics of neighborhoods that promote health and well-being. The volume of payday loans increased from \$5 billion in 1995 to \$45 billion in 2013, drawing significant financial resources out of low-income urban and rural neighborhoods.<sup>13</sup> Payday loan stores often locate in neighborhoods with large populations of people who lack credit scores, underinvested neighborhoods in downtown and rural locations, where people of color disproportionately live,<sup>14</sup> and on the outskirts of Indian Reservations and military bases (until recent regulation; see Appendix B).<sup>15</sup> Lack of access to affordable credit and inability to secure social determinants of health affect the individuals involved as well as the communities where they live.

### **SOLUTIONS BASED ON SYSTEMS THEORY**

Public health practitioners, and many others, are increasingly using "systems theory" to understand and intervene in complex systems. Systems theory holds promise because it can help distinguish between symptoms, which must be addressed in perpetuity because the root causes will keep producing them, and more influential root causes. Once root causes are understood, systems theory can then inform how solutions will need to adapt as the root causes themselves change in response to the solutions. One systems thinker claims that

<sup>11</sup> Elizabeth Sweet, L. Zachary DuBois, and Flavia Stanley, "Embodied Neoliberalism: Epidemiology and the Lived Experience of Consumer Debt," *International Journal of Health Services* 48, no 3, (2018): 501-502, <https://doi.org/10.1177/0020731418776580>.

<sup>12</sup> Human Impact Partners and ISAI AH, *Drowning in Debt: A Health Impact Assessment of How Payday Loan Reforms Improve the Health of Minnesota's Most Vulnerable*, (March 2016): 4, <https://humanimpact.org/hiprojects/paydaylendinghia>.

<sup>13</sup> Sumit Agarwal, Tal Gross, and Bhash Mazumder, "How Did the Great Recession Affect Payday Loans?" *Economic Perspectives* 40, no. 2 (2012): 3, <https://www.chicagofed.org/publications/economic-perspectives/2016/2-agarwal-gross-mazumder> and Better Business Bureau, "The Payday Loan Industry in Missouri" (2009): 2, <https://www.stlouisfed.org/~media/files/pdfs/community%20development/paydayloanreport09color.pdf>.

<sup>14</sup> Michael Turner, Patrick Walker, Chet Wiermanski, *Changing the Lending Landscape: Credit Deserts, the Credit Invisible, and Data Gaps in Silicon Valley*, PERC Results and Solutions for Silicon Valley Community Foundation. (November 2017), <http://www.perc.net/publications/changing-lending-landscape-credit-deserts-credit-invisible-data-gaps-silicon-valley/>.

<sup>15</sup> Human Impact Partners, *Drowning in Debt*, 3; CFPB, "Statement on Department of Defense Military Lending Act Final Rule," July 21, 2015, <https://www.consumerfinance.gov/about-us/newsroom/cfpb-statement-on-department-of-defense-military-lending-act-final-rule>; and Center for Responsible Lending, "Let my people go: South Dakota video," October 31, 2018, <https://www.responsiblelending.org/research-publication/let-my-people-go-south-dakotans-stop-predatory-payday-lending>.



“most of the problems faced by humankind concern our inability to grasp and manage the increasingly complex systems of our world.”<sup>16</sup>

Some problems are technically complicated, but they have known solutions, such as replacing a faulty heart valve during surgery or building a high-speed train. But other challenges, called “complex” or “adaptive,” require learning to both define the problem and to find solutions that will need to adapt over time. Many stakeholders need to participate in implementing complex adaptive solutions, not one leader. To locate adaptive solutions, the stakeholders have to work in concert, shed entrenched ideas, be open to discovery, be willing to tolerate losses, and commit to building new capacities.<sup>17</sup>

People operating in complex systems like large organizations often can identify the source of a problem accurately but then in using intuition to impose solutions, they fall short of solving it. Systems theory solutions often seem counterintuitive because many experienced decision-makers tend to overreact to visible urgent symptoms and spend less attention and effort to modify harder-to-see underlying causes. Experimenting is usually needed to find good solutions to complex problems.

The personal credit system, where 81% of adults with credit scores mostly participate within the mainstream financial system and 19% without credit scores are more likely to use alternative financial services, is a complex part of an even more complex and constantly adapting larger financial system. The US financial system, in turn, interacts with systems that produce health or disease. The application of systems theory could help multiple stakeholders consider solutions that would help improve community health and racial equity.

The United Nations (UN) Sustainable Development Goals Transformations Forum offers one more useful systems theory tool: a framework that distinguishes three types of system change—incremental, reform-level and transformational (Table 1).<sup>18</sup> The UN Sustainable

Development Goals are 17 ambitious worldwide goals, like reducing poverty and hunger and increasing health and education, for global sustainability and human well-being with specific targets for progress by 2030. Meeting these targets will require orchestrated changes by leaders in many complex global systems.<sup>19</sup> A sequenced combination of well-chosen incremental, reform and transformational solutions, with experimentation and learning from feedback along the way, could be applied to the problem of lack of affordable credit to improve the health and well-being of millions Americans.<sup>20</sup>

**Table 1. Types of Change Framework, UN Sustainable Development Goals Transformations Forum**

	Incremental	Reform	Transformation
<b>Core question</b>	Are we doing things right? How can we do more of the same?	What rules are needed? What structures and processes are needed?	What is the purpose of the system? How do we know what is best?
<b>Purpose</b>	Improve performance	Change the system and its parts	Innovate, create previously unimagined possibilities
<b>Power dynamics</b>	Confirms existing rules	Open to revising rules	Open to creating new ways of thinking about power
<b>Actions</b>	Copy, duplicate	Change policies, adapt	Experiment, invent
<b>Logic</b>	Negotiation	Mediation	Envisioning

Source: UN Sustainable Development Goals Transformations Forum, 2017.

### **Incremental solutions**

Within the current financial system, incremental changes can increase access to personal credit for those currently excluded from today’s system. These solutions will improve the performance of the current system and focus on answering the questions: “are we doing things right?”

<sup>16</sup> Peter Senge, *The Fifth Discipline: The Art and Practice of the Learning Organization*, (New York: Currency/Doubleday), 2006, 14.

<sup>17</sup> Ronald Heifetz, Alexander Grashow, and Marty Linsky, *The Practice of Adaptive Leadership*, (Boston, MA: Harvard Business Press), 2009, 19-20.

<sup>18</sup> Sustainable Development Goals Transformations Forum, “Types of Change” video, <https://www.transformationsforum.net>.

<sup>19</sup> United Nations Sustainable Development Goals, <https://sustainabledevelopment.un.org>.

<sup>20</sup> ReThink Health, A Rippel Initiative, “Accelerating Progress,” <https://www.rethinkhealth.org/our-work/transforming-regions>.



and “how can we include more people in the current system?” Changes of these types are well documented and highlights include:

1. **Include more factors when calculating credit scores:** Several researchers have shown that when past history of more types of bill payments are considered in credit score formulas, including rent and utilities payment history, that neighborhoods with historically low credit scores look much more like nearby places with traditionally high average credit scores.<sup>21</sup> The Federal Deposit Insurance Corporation (FDIC) has outlined opportunities for including more measures when calculating credit scores.<sup>22</sup> Recent examples include a bill in Congress that proposes using more data to create credit scores and FICO 9.0, which takes rental payment history into account.<sup>23</sup> The national credit rating agencies also use past alternative financial services credit payment history data but it is not clear whether considering this data to increase access to credit would improve or reduce population health and racial equity.
2. **Take a borrower’s ability to pay interest into consideration when approving loans:** Pew Charitable Trust and others recommend that loan payments be limited to 5% of a borrower’s monthly income and not exceed a term of up to six months.<sup>24</sup> This rule would set an upper limit on the amount of material hardship payday loan fees create.
3. **Reduce the density of payday loan storefronts in particular neighborhoods:** Payday lenders tend to cluster in neighborhoods with a majority of people of color and in rural small towns. Some localities restrict the presence of these storefronts in an effort to keep more resources circulating within the local economy.<sup>25</sup> For example, the Department of Defense acted in 2006 to reduce payday storefronts near military bases by calling for interest rates not to exceed 36% for military borrowers.
4. **Increase transparency around how credit scores are calculated:** The opacity around how credit scores are calculated makes it challenging for many low-income, less educated, and disabled adults to understand how to qualify for affordable credit and how to retain high credit scores.
5. **Improve the financial capability of borrowers:** Some borrowers reportedly misinterpret a \$15 fee every two weeks per \$100 borrowed as a 15% interest rate.<sup>26</sup> Financial capability training, including from community health workers, can help people navigate today’s credit system.<sup>27</sup>
6. **Collect more customer well-being information:** Lenders could collect and publicly share more customer survey and focus group data to gain information about the external costs created by high interest loans and about the well-being of borrowers and their neighborhoods.

<sup>21</sup> Turner, Walker, and Wiermanski, *Changing the Lending Landscape*, 4-5, 34-41.

<sup>22</sup> Federal Deposit Insurance Corporation, *2017 National Survey of Unbanked and Underbanked Households*. (October 2018): 67, <https://www.fdic.gov/householdsurvey/2017/2017report.pdf>.

<sup>23</sup> “FICO Score 9 – What’s the difference?” *my FICO blog*, June 8, 2017, <https://blog.myfico.com/fico-score-9-whats-the-difference>.

<sup>24</sup> Pew Charitable Trusts, “Payday Loan Facts and the CFPB’s Impact,” May 2016, <https://www.pewtrusts.org/en/research-and-analysis/fact-sheets/2016/01/payday-loan-facts-and-the-cfpbs-impact>.

<sup>25</sup> Nathalie Martin and Robert N. Mayer, “What communities Can Do to Rein in Payday Lending: Strategies for Successful Local Ordinance

Campaigns through a Texas Lens,” *Law and Contemporary Problems* 80, no. 147, 2017: 147–75, <http://scholarship.law.duke.edu/lcp/vol80/iss3/7>.

<sup>26</sup> CFPB, “Ask CFPB/Payday loans,” June 5, 2017, <https://www.consumerfinance.gov/ask-cfpb/my-payday-lender-said-my-loan-would-cost-15-percent-but-my-loan-documents-say-the-annual-percentage-rate-apr-is-almost-400-percent-what-is-an-apr-on-a-payday-loan-and-how-should-i-use-it-en-1625>.

<sup>27</sup> Global to Local, “Community health workers,” <https://www.globaltolocal.org/programs>.



## Reform solutions

Reform-level changes address what rules are needed for strong system performance, along with what structures and processes are needed to achieve the system's goals. Solutions below use the goal of increasing the health and well-being of adults who today have limited access to affordable credit. Solutions that would reform today's personal credit system include:

1. **Cap interest rates:** At the state or federal level, interest rates on short-term unsecured small dollar loans could be limited. Prior to the 1990s, a majority of states required 17% to 42% interest rate caps for small loans. An FDIC pilot program showed how banks could profitably offer affordable small-dollar loans in 2010, and 17 states restrict small dollar loan interest rates, often at 36%.<sup>28</sup>
2. **Expand public banks:** The US Postal Service served as a public bank from 1910 to 1967 and many have called for it to offer low-cost banking services again.<sup>29</sup> This solution could be especially beneficial for rural residents. The Bank of North Dakota is a public bank in operation since 1919 and the Territorial Bank of American Samoa opened in 2016 and expanded in 2018. In the five years before having a public bank, no commercial loans were reportedly made in American Samoa.<sup>30</sup> At least 25 initiatives and 30 states are exploring public banks.<sup>31</sup>
3. **Make greater use of lending circles:** Lending circles shift loan decision-making power to the local level.<sup>32</sup> Lending circles have been used in the US

through informal associations and organizations like the Mission Asset Fund, which has lent close to \$10 million to more than 8,000 borrowers and seen a 99.1% repayment rate.

4. **Base loans on character rather than credit scores:** Similarly, lending can be based on character assessments from people with local longstanding relationships with borrowers rather than poorly understood algorithm-based credit scores.<sup>33</sup> One community development corporation in South Florida has used a character loan process instead of credit scores to make housing-related loans without a single default in 14 years. A Kentucky community development financial institution has used character loans to make 1,500 small business loans. There are now more than 100 businesses led by black entrepreneurs in that local Chamber of Commerce.<sup>34</sup>

## Transformational solutions

Transformational system changes ask bigger questions like “what is the purpose of the system?” and “what criteria do we use to understand what is best?” Transformational solutions use innovation to create previously unimagined options. Solutions that have not yet been thought of could be surfaced through transformational actions that include borrowers, lenders and other stakeholders working together on visioning, experimenting and inventing. These solutions are often found by being open to creating new ways of thinking about power within the system. Initial options for transformational solutions include:

<sup>28</sup> FDIC Quarterly, “A Template for Success: The FDIC’s Small-Dollar Loan Pilot Program,” <https://www.fdic.gov/bank/analytical/quarterly/2010-vol4-2/fdic-quarterly-vol4no2-smalldollar.pdf>.

<sup>29</sup> Eisenberg-Guyot, Firth, Klawitter, and Hajat, “From Payday Loans to Pawnshops,” 436.

<sup>30</sup> Blackwell, Rob. “American Samoa Finally Gets a Public Bank. And US States are Watching.” *American Banker*, April 30, 2018. <https://www.americanbanker.com/news/american-samoa-finally-gets-a-public-bank-and-us-states-are-watching>

<sup>31</sup> Public Banking Institute, <http://www.publicbankinginstitute.org>.

<sup>32</sup> Mission Asset Fund, “Impact,” <https://missionassetfund.org/impact>.

<sup>33</sup> Family Independence Initiative, “UpTogether,” <https://www.fii.org/approach/uptogether>.

<sup>34</sup> Lillian M. Ortiz, “When a Person’s Character Trumps their Credit Score,” *Shelterforce*, August 23, 2017, <https://shelterforce.org/2017/08/23/persons-character-trumps-credit-score>.



1. **Consider when financing versus other mechanisms work best to ensure access to social determinants of health:** Social determinants of health comprise 80% of what is needed to be healthy.<sup>35</sup> Financing may not ensure that basic needs are met for everyone, particularly for vulnerable populations. Alternatively, basic needs can be met through social policy.<sup>36</sup> High interest loans seem to be connected to stress pathways that can harm health. Strengthening social welfare programs, increasing the minimum wage, testing targeted and universal basic income policies, and increasing labor protections could reduce the population's demand for and exposure to short-term high interest loans.<sup>37</sup>
2. **Build an economy that is inclusive, equitable and prosperous:** Many public and private sector organizations are working intentionally to include those previously left out of the benefits of economic growth.<sup>38</sup> Credit rating agencies have taken steps to be more inclusive by using new variables when establishing credit scores. Many now put less weight on medical debt and are willing to include history of rent payments not just mortgage payments.<sup>39</sup>

Local and state governments are increasingly acknowledging that their own past actions, including redlining and other racist patterns of education, tax, land use, and criminal justice policies, have contributed to today's inequities by race and by place and are taking actions to

reckon with and make up for these past and current harms.<sup>40</sup> Lenders and the national credit rating agencies' leadership may want to explore how to counteract past discriminatory impacts of lending practices. One place to start is with Racial Equity Here, a national initiative of over 600 organizations, including more than 80 businesses, which have committed publicly to learn, act and partner to reduce racial inequities.<sup>41</sup> The three main credit rating agencies appear to be governed by 96% white and 80% male board of directors and senior managers and may have blind spots regarding how a lack of credit score affects the public.<sup>42</sup>

3. **Find new unimagined solutions:** If the US has a goal of ensuring equal opportunity for life, liberty, and the pursuit of happiness, there are many as yet unthought-of ways for these ideals to be implemented. Systems thinkers call on us to realize that no paradigm is the absolute truth and to acknowledge that as humans we have a limited understanding of complex systems. If we let go of the need to know and instead see the world with curiosity, possibility, and potential, we may be able to change systems more deeply and rapidly than we can now predict.<sup>43</sup>

<sup>35</sup> County Health Rankings & Roadmaps, "County Health Rankings Model," <https://www.countyhealthrankings.org/explore-health-rankings/measures-data-sources/county-health-rankings-model>.

<sup>36</sup> Greta R. Krippner, "Democracy of Credit: Ownership and the Politics of Credit Access in Late Twentieth-Century America," *American Journal of Sociology* 123, no.1, (July 2017): 1-47, <https://doi.org/10.1086/692274>.

<sup>37</sup> Eisenberg-Guyot, Firth, Klawitter, and Hajat, "From Payday Loans to Pawnshops," 442.

<sup>38</sup> PolicyLink, *All-In Cities: Building an equitable economy from the ground up*, 2016, 4, [http://allincities.org/sites/default/files/AIC\\_2016-update\\_WebOnly.pdf](http://allincities.org/sites/default/files/AIC_2016-update_WebOnly.pdf).

<sup>39</sup> "FICO Score 9," my FICO blog.

<sup>40</sup> Government Alliance on Race & Equity, "About," <https://www.racialequityalliance.org/about>.

<sup>41</sup> Racial Equity Here, "A National Movement to Advance Racial Equity by Dismantling Structural Racism," <https://racialequityhere.org>.

<sup>42</sup> Author's visual analysis of online photos of board and senior management team members. This analysis could contain inaccuracies that self-reporting would improve.

<sup>43</sup> Donella Meadows, *Thinking in Systems: A Primer*, Editor Diana Wright, (Chelsea Green Publishing, White River Junction, Vermont: 2008) 145-165.





## RESEARCH AGENDA

Additional research on short-term high interest loans as a risk factor for health can inform the selection, sequence, and implementation of solutions. This initial research agenda is organized by who could use the research and how they could benefit from greater understanding of the relationships between high-cost short-term loans and health.

### *Healthy community practitioners*

Those implementing and evaluating healthy community place-based initiatives have sometimes explored how personal and community access to credit, whether low-interest or high-cost, shapes health and well-being.<sup>44</sup> These efforts are starting to build the evidence on both problem identification and solutions, but more could be done. Data on the use of high-cost loans, exposure to online payday loan advertisements and density of payday loan stores should be included in the groundbreaking data integration work currently underway. Analysis of longitudinal linked de-identified person-level data can inform the relationships between high-cost loans and health. Both access to low-cost loans and exposure to high-cost loans and their distinct connections to health warrant further research.

The effects of personal credit scores, or lack thereof, on neighborhood financial ecosystems also need further study. This research can now use a comprehensive framework for analyzing capital flows through communities that has been developed by the Urban Institute.<sup>45</sup>

### *Health care providers*

Health care providers may want to screen for credit scores and debt burden, differentiating between burdensome

higher interest and affordable lower interest loans. Physicians can consider payday lending in their deliberations about whether they have a responsibility to take financial consequences like medical debt into account when treating patients.<sup>46</sup> Beyond treating their own patients, health care providers can act to make community-level policy changes, including influencing policies that can reduce the causes of financial instability and those that can protect their patients' from stressful high cost lending and debt collection practices.<sup>47</sup> This research agenda could be expanded by examining the possible positive health effects of debt forgiveness and the probable negative health effects of some debt collection practices.

### *Medicaid Directors*

Medicaid Directors and researchers could compare the costs of health care services in states and localities that permit payday lending with those that do not. The excess costs of health care services that may result from the health consequences of payday lending could be estimated. This research need not be limited to payday loans and could add to our understanding of the types of health care conditions that are sensitive to the stress of various forms of over-indebtedness, including sub-prime mortgages, medical debt and student loans.<sup>48</sup>

### *State, Territorial, County, City, and Tribal Health Officers, Health Departments, and Health Boards*

Public health officers at all levels of government can monitor and call for action on their population's exposure to high interest loans given the evidence offered by the two 2018 epidemiologic studies. Kansas City, Missouri's Community Health Improvement Plan lists decreasing the negative health impact of predatory lending as one of its

<sup>44</sup> Examples include the Family Independence Initiative, <https://www.fii.org/sites-partnerships>; National Neighborhood Indicators Partnership, <https://www.neighborhoodindicators.org>; Data Across Sectors for Health, <http://dashconnect.org>; and Research Improving People's Lives, <https://www.ripl.org>.

<sup>45</sup> Brett Theodos, Eric Hangen, Carl Hedman, and Brady Meixell, "Measuring Community Needs, Capital Flows, and Capital Gaps." Urban Institute, November 2018, <https://www.urban.org/research/publication/measuring-community-needs-capital-flows-and-capital-gaps>.

<sup>46</sup> Peter A. Ubel and Reshma Jaggi, "Promoting Population Health through Financial Stewardship," *New England Journal of Medicine*,

370, no. 14, (2014): 1280-1281, <https://www.neim.org/doi/10.1056/NEJMp1401335>.

<sup>47</sup> Brian Castrucci and John Auerbach, "Meeting Individuals Social Needs Falls Short of Addressing Social Determinants of Health," *Health Affairs blog*, January 16, 2019, <https://www.healthaffairs.org/doi/10.1377/hblog20190115.234942/full>.

<sup>48</sup> Katrina M. Walsemann, Gilbert C. Gee and Danielle Gentile. "Sick of Our Loans: Student Borrowing and the Mental Health of Young Adults in the United States," *Social Science & Medicine* 124 (January 1, 2015): 85–93. <https://doi.org/10.1016/j.socscimed.2014.11.027>.



top goals.<sup>49</sup> Those monitoring and protecting population health also can support more research into this potential risk factor and solutions that could alleviate this burden on health.

### **Researchers of Women’s, Minority, Disabled, and Rural Health**

Health researchers concerned with specific populations who are disproportionately exposed to payday loans, such as women, people of color, disabled and rural residents, can do more research on payday loans and other forms of high cost credit and over-indebtedness. These populations overlap and research on the intersections between them could be especially informative.

### **Economists and financial analysts**

Many economic analyses of payday loans report exclusively on the number and characteristics of financial transactions. Economists and financial analysts could complement these studies with research that uses people and neighborhoods as units of analysis, as a Consumer Financial Protection Bureau (CFPB) report series on credit invisibles did. The CFPB reported overall findings by race/ethnicity groups after imputing values from census tract race/ethnicity data.<sup>50</sup> Even finer grained analysis can inform the design of well-targeted solutions, using categories such as young black women or Latino working-age men.

### **Community developers**

Some place-based community development initiatives have been disappointed not to see long lasting changes for community residents, although a handful have seen great progress.<sup>51</sup> The presence of affordable financing and the

absence of predatory lending may have been a component of why some have experienced traction and others have been challenged.

Community developers can routinely use a racial equity impact assessment rather than a race-neutral or race-silent approach in their work to make sure they are not overlooking systemic causes of poverty.<sup>52</sup> For example, community developers often use market value analyses to inform where investments are made. But if a market value analysis is based on measures like the annual number of property sales in a neighborhood, this investment tool could perpetuate racial inequities because people of color are less likely to have credit scores and qualify for mortgages.<sup>53</sup>

### **Public health researchers**

Public health professionals can give greater consideration to debt and capital flows as potentially positive or negative factors that can influence health. The financial system has direct effects on health and it shapes the systems that influence how social determinants are accessed. In the same way that healthy affordable food leads to good health and unhealthy food and beverages contribute to poor health, “healthy” affordable loans and “unhealthy” high-cost loans could be studied by more public health researchers in collaboration with finance experts. Public health researchers could expand this research agenda by documenting potential positive health effects of loan forgiveness policies. Historically, the biblical Law of the Jubilee required lenders to forgive all loans every seven years.<sup>54</sup> Education loan forgiveness is being debated today to relieve students’ \$1.5 trillion debt level and the health effects of these policies should be studied.<sup>55</sup>

<sup>49</sup> Kansas City, MO, Community Health Improvement Plan, 2016-2021, April 2016, <https://dashboards.mysidewalk.com/kansas-city-mo-chip-dashboard/predatory-lending>.

<sup>50</sup> Consumer Financial Protection Bureau, *Data Point: Credit Invisibles* (May 2015): 16, [https://files.consumerfinance.gov/f/201505\\_cfpb\\_data-point-credit-invisibles.pdf](https://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf).

<sup>51</sup> Build Healthy Places Network, <https://www.buildhealthyplaces.org> and Annie E. Casey Foundation, “Community Change: Lessons from Making Connections, May 2, 2013. <https://www.aecf.org/resources/community-change-lessons-from-making-connections>.

<sup>52</sup> Racial Equity Impact Assessment toolkit, Race Forward, <https://www.raceforward.org/practice/tools/racial-equity-impact-assessment-toolkit>.

<sup>53</sup> Laura Choi, “Inclusion, Racial Equity, and Community Development: Lessons from the 2018 National Interagency Community Reinvestment Conference.” Federal Reserve Bank of San Francisco, *Community Development blog*, May 24, 2018, <https://www.frbsf.org/community-development/blog/inclusion-racial-equity-community-development-lessons-from-2018-national-interagency-community-reinvestment-conference>.

<sup>54</sup> David Graeber, *Debt: the First 5,000 Years*. (Brooklyn, NY: Melville House 2011), 82.

<sup>55</sup> Danielle Douglas-Gabriel, “How Julian Castro’s student debt forgiveness proposal stacks up against Elizabeth Warren’s,”



The negative health effects of experiencing the debt collection process are also important to understand. An estimated 77 million adults have been contacted by debt collectors.<sup>56</sup> Civil courts have issued thousands of arrest warrants for borrowers who failed to provide their personal financial information to debt collectors. Debtor prisons were outlawed in the US in 1833, but hundreds of people have been arrested and jailed for contempt of court charges after failing to appear at court proceedings to answer questions from debt collectors about their financial situation. Many who were incarcerated said they were not aware of their court date nor that they were required to disclose this information. The health consequences of experiencing different types of debt collection practices, the arrest process and the associated jail stays could be measured and weighed against the value of the amounts borrowed, which were very low in some cases.<sup>57</sup>

## CONCLUSION

The fields of public health and community development have drawn closer since the Robert Wood Johnson Foundation (RWJF) supported work on the Commission to Build a Healthier America in 2005.<sup>58</sup> RWJF's Culture of Health Action Framework with health equity at its center has sparked strategic collaborations across many sectors since 2014.<sup>59</sup> Community developers and public health practitioners, along with community leaders and people from other sectors, are building knowledge by experimenting with interventions designed by multi-sector initiatives to improve economic mobility, health and well-being. The Strong, Prosperous, and Resilient Community Challenge and the California Endowment's Building

Healthy Communities initiatives are joined by several other place-based and policy change efforts making progress and sharing lessons learned.<sup>60, 61</sup> Creative co-design with people affected by lack of access to low-cost credit and greater use of racial equity impact assessments could help speed the design and adoption of new solutions. Public and private funders and lenders can act together on community priorities to create financing vehicles that can lead to a more inclusive economy while improving health.

Lack of credit scores and high-cost loans create at least two types of burdens on the economies and health of low-income urban and rural neighborhoods. First, financial resources are removed from low-income people's budgets and neighborhoods and are aggregated in the payday lending business and the equity funds (usually located out of state or out of the US) that finance them.<sup>62</sup> Second, the health effects of the stress of living in a debt trap are measurable, and less healthy people are less able to work and lead full lives. In the short run, these poor health consequences are likely paid for by state Medicaid programs and the larger health care system which incur the costs of increased use of associated health care services. In the long term, innumerable costs are borne by the individuals and their neighborhoods when scarce funds go to paying high cost interest rather than meeting their own and their families' basic needs and supporting their dreams for a better life.

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*Washington Post*, May 22, 2019,

[https://www.washingtonpost.com/education/2019/05/22/how-julian-castros-student-debt-forgiveness-proposal-stacks-up-against-elizabeth-warrens/?utm\\_term=.18eae547a4b8](https://www.washingtonpost.com/education/2019/05/22/how-julian-castros-student-debt-forgiveness-proposal-stacks-up-against-elizabeth-warrens/?utm_term=.18eae547a4b8).

<sup>56</sup> Jennifer Turner, *A Pound of Flesh: the Criminalization of Private Debt*, (Washington DC: American Civil Liberties Union 2018), 4, <https://www.aclu.org/report/pound-flesh-criminalization-private-debt>.

<sup>57</sup> Turner, *A Pound of Flesh*, 9.

<sup>58</sup> Commission to Build a Healthier America, "Recommendations," (April 2009), <http://www.commissiononhealth.org/Recommendations.aspx>.

<sup>59</sup> Robert Wood Johnson Foundation, "Building a Culture of Health," <https://www.rwjf.org/content/rwjf/en/cultureofhealth/taking-action.html>.

<sup>60</sup> John Moon, "Investing to Reduce Economic and Racial Disparities," Federal Reserve Bank of San Francisco, *Community Development Blog*, July 28, 2016, <https://www.frbsf.org/community-development/blog/investing-to-reduce-economic-racial-disparities>.

<sup>61</sup> California Endowment, Building Healthy Communities, <https://www.calendow.org/building-healthy-communities> and Build Healthy Places Network.

<sup>62</sup> Michael A. Stegman, "Payday Lending," *Journal of Economic Perspectives* 20, no. 1, 2007: 172; Better Business Bureau, "Payday Loan Industry," 3 and Erin Carlyle, "Mexican Billionaire Buys Advance America, Largest Payday Lender in US," *Forbes*, April 23, 2012, <https://www.forbes.com/sites/erincarlyle/2012/04/23/mexican-billionaire-buys-advance-america-largest-payday-lender-in-us/#3dd1382a1799>.



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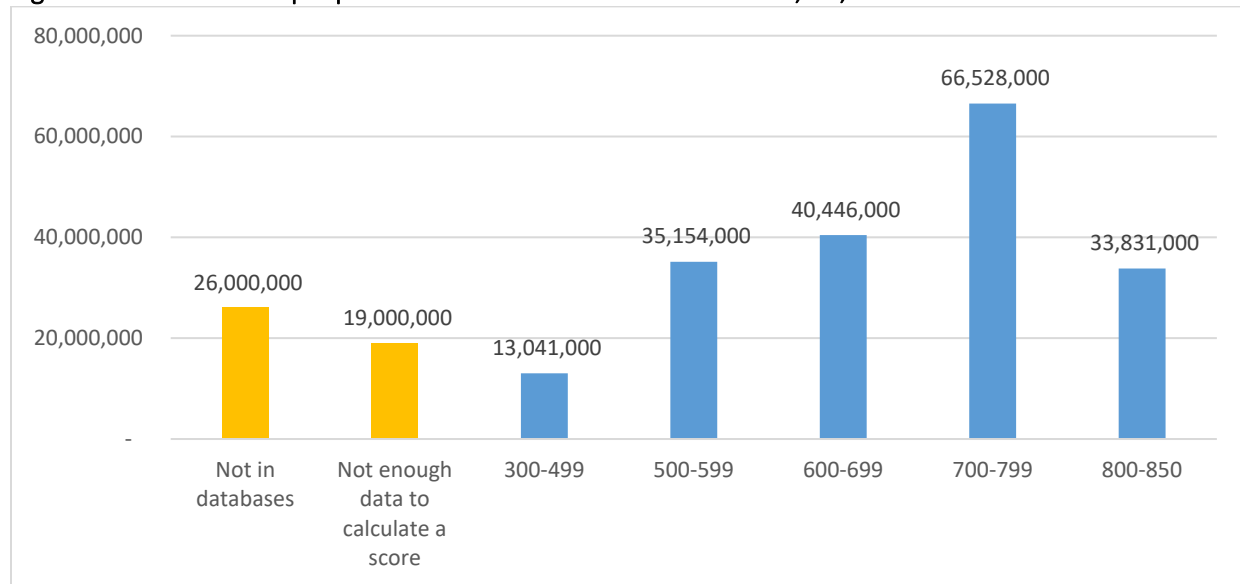
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## APPENDIX A. LACK OF CREDIT SCORES

The Fair Isaac Corporation (FICO) developed a proprietary formula to calculate credit scores in 1956. History of late payments, loan balance, length of credit history, number of recent credit reports issued and variety of loans contribute to an individual's score. Equifax, Experian and TransUnion are national credit rating agencies that use algorithms to create and update credit scores for 81% of the adult population—189 million Americans as of 2010. 19 million people (8%) were in the credit rating agencies' datasets but did not have enough data to calculate a score. 26 million adults (11%) were not in these databases. In total, 45 million (19%) US adults did not have credit scores.<sup>63</sup>

Figure 1. Distribution of people with no credit score and with scores, US, 2010



Sources: CFPB *Data Point: Credit Invisibles* and FICO Blog<sup>64</sup>

### What are the consequences of lacking a credit score?

Credit scores traditionally determine access to and terms of mortgages, car loans, and credit cards. Today, credit scores also routinely affect hiring, promotions, renting an apartment, cell phone access, cable subscriptions, car insurance rates, immigration status decisions, and obtaining utilities or renting cars without a deposit.<sup>65</sup>

<sup>63</sup> CFPB, *Data Point: Credit Invisibles*, 6.

<sup>64</sup> FICO Blog, "US Average FICO Score Hits 700: A Milestone for Consumers," September 24, 2018, <https://www.fico.com/blogs/risk-compliance/us-average-fico-score-hits-700-a-milestone-for-consumers>.

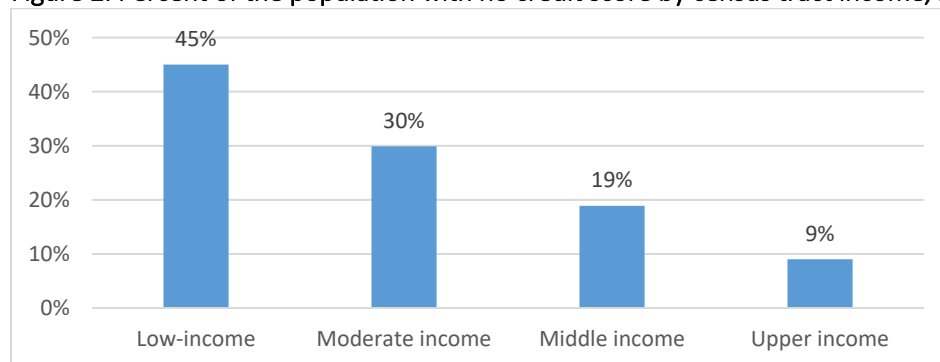
<sup>65</sup> Consumer Financial Protection Bureau, *Who are the Credit Invisibles?* (December 2016), 7, [https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201612\\_cfpb\\_credit\\_invisible\\_policy\\_report.pdf](https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/201612_cfpb_credit_invisible_policy_report.pdf) and Gerri Detweiler, "Will Bad Credit Stop You from Getting Cable?" *Credit.com*, March 24, 2014, <https://blog.credit.com/2014/03/will-bad-credit-stop-you-from-getting-cable-78764>.

With limited access to affordable credit, 45 million Americans' options to secure personal loans are alternative financial services credit (e.g. payday loans), self-funding, relying on friends and relatives, or doing without.<sup>66</sup>

### Who has no credit score?

The Consumer Financial Protection Bureau (CFPB) reports that almost half (45%) of the residents of low-income neighborhoods lack credit scores compared to 9% in upper income places.

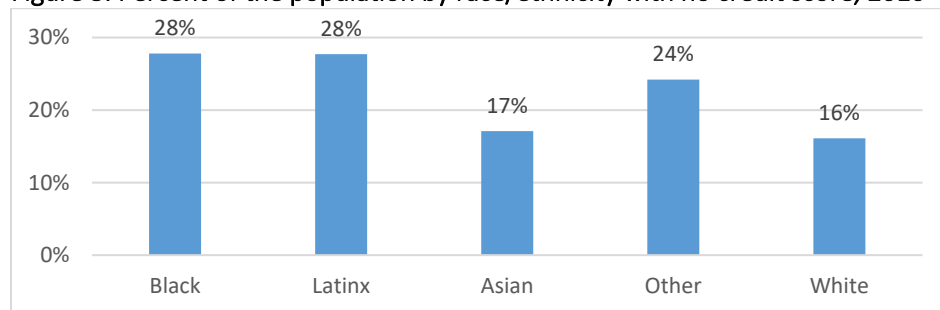
**Figure 2. Percent of the population with no credit score by census tract income, 2010**



Source: CFPB, *Data Point: Credit Invisibles*, 33, and *Who are the credit invisibles?*, 3.

Low-income, Black and Latinx, and rural residents of the US are disproportionately likely to lack a credit score. More than one in four (28%) Black and Latinx adults did not have credit scores in 2010. By contrast, 16% of White and 17% of Asian adults lack a score. These figures are consistent with more recent data from 2017 when 30% of Blacks and 23% of Latinx versus 13% of Whites reported having no credit card.<sup>67</sup>

**Figure 3. Percent of the population by race/ethnicity with no credit score, 2010**



Source: CFPB, *Data Point: Credit Invisibles*, 33.

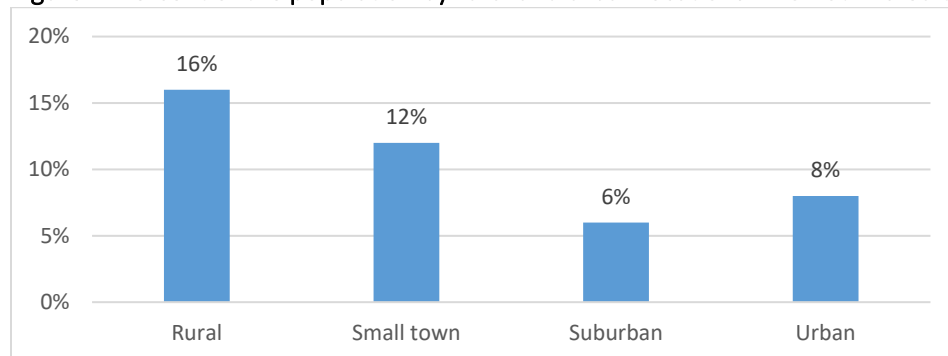
A geographic analysis of the 11% of US adults (26 million) who are not in credit rating agencies' databases at all shows that these Americans are more likely to live in rural, small town and urban areas than in the suburbs. About 16% of rural residents lack credit scores across low-, middle-, and even high-income rural

<sup>66</sup> CFPB, *Who Are the Credit Invisibles?* 7, and Pew Charitable Trusts, *Payday Lending in America*, 16.

<sup>67</sup> Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2017*, (2018), 28, <https://www.federalreserve.gov/publications/2018-economic-well-being-of-us-households-in-2017-preface.htm>.

locations, a different pattern from urban, suburban and small towns where the prevalence of having no credit scores declines with higher income.<sup>68</sup>

**Figure 4. Percent of the population by rural and urban locations who not in credit rating datasets, 2010**



Source: Consumer Financial Protection Bureau. *Data Point: The Geography of Credit Invisibility*, 11.

The cities with the highest percentage of residents lacking credit scores tend to have large percentages of Black and Latinx residents. Rural areas in the South are particularly likely to be places where residents lack credit scores. Almost one in four adults (24%) lack scores in 13 small cities throughout the Southeast, such as Helena, AR; Indianola, MS and Bennettsville, SC, and in 10 of these cities, Black or Latinx residents comprise over half the town's population.<sup>69</sup>

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<sup>68</sup> Consumer Financial Protection Bureau, *Data Point: The Geography of Credit Invisibility*, (2018), 12, [https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/bcfp\\_data-point\\_the-geography-of-credit-invisibility.pdf](https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/bcfp_data-point_the-geography-of-credit-invisibility.pdf).

<sup>69</sup> CFPB, *Who Are the Credit Invisible?* 13, and 2010 census data.

## APPENDIX B. ALTERNATIVE FINANCIAL SERVICES, SUCH AS PAYDAY LOANS

A growing number of Americans without credit scores, and those with low scores, use alternative financial services to secure personal credit.<sup>70</sup> “Alternative financial services” refers to those services or financial products that operate outside the federally insured banking system. Alternative financial services include transactions, such as check cashing; and loans, such as single payment payday loans, car title loans, rent-to-own, pawnshop loans, refund anticipation, deposit advance, and installment loans.<sup>71</sup> I focus in this paper on payday loans as one key example of alternative financial services forms of credit.

Payday loans are small dollar loans usually ranging from \$100 to \$500. Lenders typically charge \$15 every two weeks per \$100 borrowed. Payday lender users borrow \$375 in an average loan and pay an additional \$520 in average fees (400% APR) over a typical payback period of five months.<sup>72</sup> While 15% of borrowers pay off their short-term low dollar loan on the first payback date, 85% do not and borrowers are likely to pay fees (interest) bi-weekly for months.<sup>73</sup>

Three fourths of payday loan users (74%) report they do not have access to other forms of personal credit.<sup>74</sup> The similarities in the characteristics of people with no credit score and those who use alternative financial services also support this connection. Some Americans do not use commercial banks because they do not have enough money to keep in an account, they may not trust banks, and because fees are high or unpredictable.<sup>75</sup> Many of these “unbanked” and “underbanked” adults use both financial transaction and loan services at alternative financial services providers.

While the federal discount rate (the interest rate charged to banks on loans from their regional Federal Reserve Bank) is today about 3%, the prime rate and mortgage rates are about 5%, and typical credit card interest rates range from 13% to 23%, alternative financial services loan interest rates range from 100% to 677% or higher.

### Payday lending history

Payday-type loans emerged in US in the second half of the nineteenth century and surged in the early twentieth century until an estimated 25% of urban wage-earners borrowed from payday lenders in the 1910s. The Russell Sage Foundation worked with state legislators to curb this extractive financial practice by passing state Uniform Small Loan Laws that typically limited interest rates to 42% per year, and exempted small loans from states’ 6% interest rate caps in that era. These laws were passed in 75% of states between 1917 and 1950. Between the passage of the Uniform Small Loan Laws and the early 1990s

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<sup>70</sup> Neil Bhutta, Paige M. Skiba, and Jeremy Tabacman, “Payday Loan Choices and Consequences,” *Journal of Money, Credit and Banking* 47, no. 2-3 (March-April 2015): 223-260, <https://doi.org/10.1111/jmcb.12175>.

<sup>71</sup> Federal Deposit Insurance Corporation, “Alternative Financial Services: A Primer,” *FDIC Quarterly* 3, no. 1 (2009), <https://www.fdic.gov/bank/analytical/quarterly/2009-vol3-1/fdic140-quarterlyvol3no1-afs-final.pdf>.

<sup>72</sup> Pew, *Payday Lending*, 4.

<sup>73</sup> CFPB, *Data Point: Payday Lending*, 26.

<sup>74</sup> Community Financial Services Association of America, “Borrower and Voter Views of Payday Loans,” (February 2016), <https://www.cfsaa.com/news/access-to-credit/new-survey-borrowers-are-far-more-favorable-toward-payday-loans-than-voters-without-experience>.

<sup>75</sup> FDIC, *2017 National Survey of Unbanked*, 4.



there were very few legal payday loan stores in the US.<sup>76</sup> After bank deregulation in the late 1970s and 1980s and with new access to mainstream financing, payday lending began increasing in states that allow this financial practice.

### **What happens when payday loans are not available?**

Nine states have not permitted payday lending since their Uniform Small Loan Law was passed and eight more have prohibited payday lending since 2004. Payday lending is permitted in 33 states and is a growing practice online. To be sure, low-income residents in these 33 states might receive a convenience in the short term from the cash a payday loan offers, but others have made do without them in many states over many decades. Four out of five payday borrowers say they would cut back on expenses if payday loans were not available.<sup>77</sup> One common argument against regulating payday loans is that it would result in a stronger presence of black market loan sharks, however one study found no evidence of illegal high interest small loan operations after reviewing both federal indictments for extortionate lending and local press stories in seven states that have long banned payday lending: Connecticut, Maine, Maryland, New Jersey, New York, Pennsylvania and Vermont.<sup>78</sup>

### **Growth in payday lending from the mid-1990s to today**

In 1996, there were an estimated 2,000 payday loan stores; by 1999, there were 10,000; and in 2013 there were 18,000 stores.<sup>79</sup> The volume of payday loans increased from \$5 billion in 1995 to \$45 billion in 2013. The growth accelerated from the late 1990s through today as smaller payday lending operations consolidated and the parent companies secured loans from commercial banks, public pensions and private equity funds.<sup>80</sup> In 2016, US consumers paid \$29 billion in fees and interest on payday, pawn shop, refund anticipation, installment, rent-to-own and car title loans.<sup>81</sup> By comparison, total philanthropic giving by foundations in the US was \$67 billion in that year.<sup>82</sup>

Online payday lender loan volume increased fivefold from 2013 to 2017, with 44% of all online payday loans coming from two states: California and Texas. Online payday loan users tend to be younger (41- versus 48-years-old on average) and slightly higher income than storefront users (earning \$33,500 per year on average versus \$23,300 per year). Online lenders offer both single payment and installment loans, with the fastest growth seen in installment loans.<sup>83</sup>

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<sup>76</sup> Robert Mayer, "Loan Sharks, Interest-Rate Caps, and Deregulation," *Washington & Lee Law Review* 69, no. 2 (2012): 807-848, <https://scholarlycommons.law.wlu.edu/wlulr/vol69/iss2/10>.

<sup>77</sup> Pew, *Payday Lending*, 16.

<sup>78</sup> Mayer, "Loan Sharks," 841-843.

<sup>79</sup> Agarwal, Gross and Mazumder, "How Did the Great Recession Affect Payday Loans?" 3 and Better Business Bureau, "The Payday Loan Industry in Missouri," 2.

<sup>80</sup> Dan Primack, "Public Pensions Own Payday Lender that is Illegal in their Own States." *Fortune*, (April 20, 2015) <http://fortune.com/2015/04/20/public-pensions-payday-loans>; Americans for Financial Reform, "Payday Lending and the Private Equity Business," (December 2017), <http://ourfinancialsecurity.org/2017/12/afr-report-payday-lending-private-equity-business/> and offering materials at <http://investor.onemainfinancial.com/CustomPage/Index?keyGenPage=328791>.

<sup>81</sup> Center for Financial Services Innovation, *2017 Financially Underserved Market Size Study*, (December 2017), 12-13, <https://cfsinnovation.org/research/2017-financially-underserved-market-size-study/>.

<sup>82</sup> National Philanthropic Trust, "Charitable Giving Statistics 2017," <https://www.nptrust.org/philanthropic-resources/charitable-giving-statistics>.

<sup>83</sup> Experian, "2017 Subprime Lending Trends: Insights into Consumers and the Industry," (April 2017): 5-14, <https://www.clarityservices.com/wp-content/uploads/2018/04/2018-AFS-Lending-Trends-Report.pdf>.

### Who uses alternative financial services?

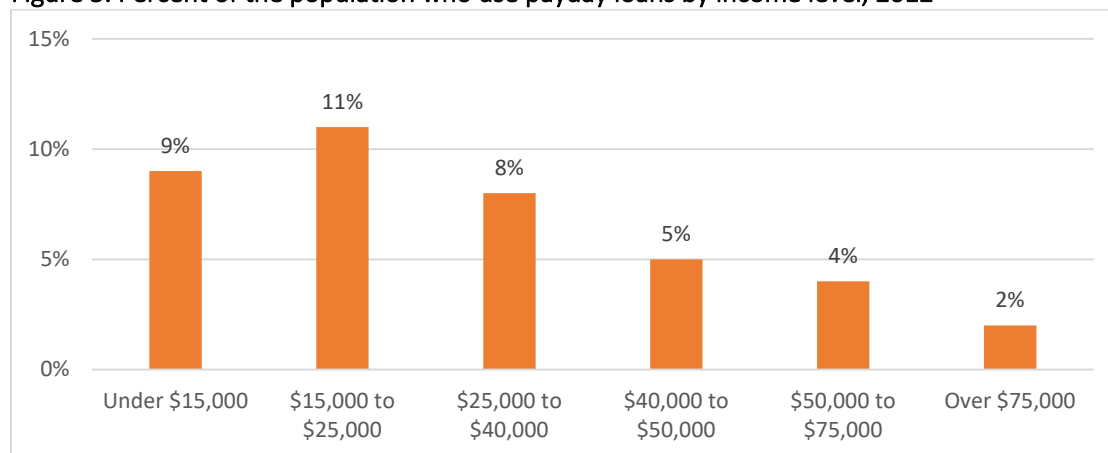
Depending on what source is used, an estimated 5% to 8% of Americans use payday loans. The FDIC reported that 7% of US adults in 2017 sought loans from alternative financial services providers.<sup>84</sup> This figure is consistent with a Pew Charitable Trusts survey of 33,576 Americans in 2011 which found that 5.5% had used payday loans and with a Government Accountability Office (GAO) report that 8% of households used alternative financial services credit in 2015.<sup>85</sup>

The rate of payday loan use varies by gender, disability, income, race/ethnicity, rural/urban location and by state of residence. Slightly more than half of those using payday loans are women (52%) and people with disabilities are twice as likely as the general population to use payday loans (12% versus 6%).<sup>86</sup>

Similar to the distributions of those lacking credit scores, payday loan users are more likely to have lower incomes, be people of color, and live in urban and rural areas versus suburban locations.

While only 2% of those with incomes over \$75,000 use payday loans, 11% of people with incomes between \$15,000 and \$25,000 do so. Black people are three times more likely to use payday loans than White people are. Urban and rural residents are twice as likely to use payday loans as suburban residents are.

**Figure 5. Percent of the population who use payday loans by income level, 2012**



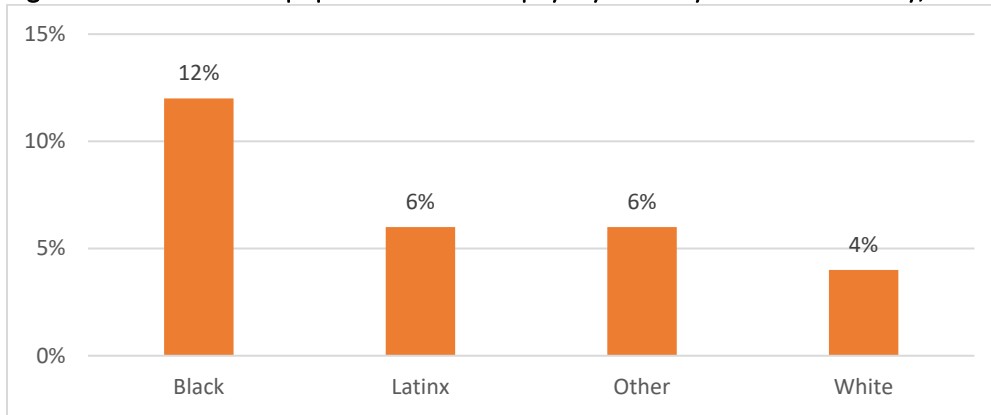
Source: Pew Charitable Trusts. *Payday lending in America: Who borrows, where they borrow, and why*, 10.

<sup>84</sup> FDIC, *Unbanked and Underbanked*, 39.

<sup>85</sup> Pew, *Payday Lending*, 35, and US Government Accountability Office, *Community Reinvestment Act: Options for Treasury to Consider to Encourage Services and Small-Dollar Loans When Reviewing Framework*, GAO-18-244, (February 2018): 18, <https://www.gao.gov/products/GAO-18-244>.

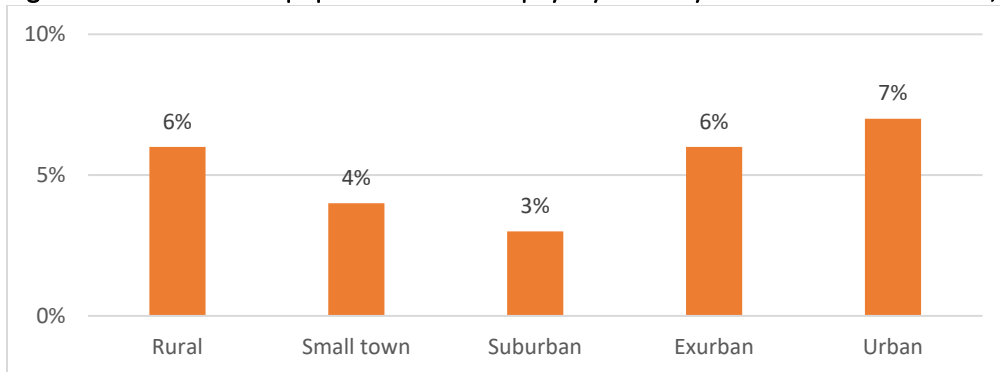
<sup>86</sup> Pew, *Payday Lending*, 35.

**Figure 6. Percent of the population who use payday loans by race and ethnicity, 2012**



Source: Pew Charitable Trusts. *Payday lending in America: Who borrows, where they borrow, and why*, 11.

**Figure 7. Percent of the population who use payday loans by urban and rural location, 2012**



Source: Pew Charitable Trusts. *Payday lending in America: Who borrows, where they borrow, and why*, 11.

### **Payday loans affect both individuals and the neighborhoods where they live**

In addition to leaving many low-income people with less money, payday lenders have consequences for the communities where they live. Payday loan stores are located in disproportionately low-income neighborhoods where people of color live, in rural places, near Indian reservations and, until 2007, near military bases. In 2006, payday lending was restricted for military personnel by limiting loan interest rates to 36%.<sup>87</sup>

### **What are payday loans used for?**

Users of payday loans report that the funds are usually used to cover basic needs. In one large survey, respondents said that 69% of first loans were taken out to cover recurring expenses like utility bills, car payments, credit cards, rent, or food; 16% of the loans were used for an unexpected expense; and 8% for a special occasion like a vacation or gift.<sup>88</sup> A smaller study found the most likely uses were for food (54%), housing (49%), utilities (41%), personal goods (38%), education (21%), vacation (21%), medical expenses (15%) and a child's expenses (13%).<sup>89</sup>

<sup>87</sup> Human Impact Partners, *Drowning in Debt*, 4.

<sup>88</sup> Pew, *Payday Lending*, 14.

<sup>89</sup> Sweet, Kuzawa, and McDade, "Short-term Lending," 117.