

Policy to Protect Financially Vulnerable Populations: A Look at the Military Lending Act

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Abstract

In this paper, I use geospatial data on payday lending storefronts to assess a landmark federal policy initiative: the 2007 Military Lending Act (MLA), which created a federal interest rate cap on consumer loans to military members, and its 2016 revision. I ask whether the implementation of the 2007 and 2016 MLAs resulted in a reduction in the number of payday storefronts within military communities, leveraging state-level variation in payday lending laws. The 2007 analysis shows that the MLA alone had virtually no impact on reducing payday loan exposure in military communities. In contrast, state-wide restrictions capping interest rates for all consumers was effective in reducing payday lender presence in all communities across the state, including military areas. These initial findings suggest that MLA as implemented was a misaligned policy solution and that universal regulation may be most effective in reducing military exposure to subprime financial services. The 2016 MLA presents an opportunity to further test this working argument. By assessing the 2007 and 2016 MLA in tandem with broader state policies, this study provides insights on best paths forward for policymakers with regards to the structure and scope of consumer protection for financially vulnerable populations.

Objective

In the early 2000s, the Department of Defense (DoD) noticed a growing problem: high-interest lenders were cropping up around military bases like “bears on a trout stream” (Graves and Peterson 2005:824; Petraeus 2013). Almost overnight, predatory lending practices began to threaten the financial standing of many enlisted servicemembers (Department of Defense 2006). In response, Congress enacted the Military Lending Act (MLA) in 2007, a law that designated a 36% “Military Annual Percentage Rate” to cap fees and interest on short-term consumer loans to active duty servicemembers and their dependents. In theory, this interest rate cap should effectively make military consumers an unviable market for payday lenders. Yet, internal DoD surveys show that after the initial law, payday lenders were able to evade regulation and continue to profit from military borrowers (Department of Defense 2014). In 2016, the cap was extended to a broader set of loan products in an effort to strengthen the law.

It remains unknown whether the MLA successfully limited access to predatory financial services by reducing servicemembers’ geographic *exposure* to payday lenders.

In other words, did the law, either in its initial form or with its substantive 2016 revision, get rid of the bears on the trout stream?

My findings to date suggest that the 2007 MLA alone did not reduce exposure to payday lending storefronts in military communities. However, in states with broader payday lending restrictions, the number of payday storefronts operating within military communities decreased as part of state-wide reductions. These analyses indicate that policies may be most effective in protecting financial vulnerable populations if they are enacted through broader regulations and/or support the development of low-cost alternatives that apply to all consumers.

In next steps, I will conduct similar analyses for the 2016 MLA revision. While the revision extended its product reach, the target population remained the same. As such, it provides an opportunity to further assess whether universal policies and laws that cover all consumers better protect financially vulnerable populations, rather than simply covering additional loan products for a targeted population.

Significance

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This study has important implications for policy debates about high-interest lending. Credit has become a fundamental part of household finance within the United States in recent decades (Krippner 2017), but access to and the terms of credit products are highly unequal (Dwyer 2018). Payday lenders, which offer short-term small-dollar loans at high interest rates, seek customers who have a steady paycheck and bank account, but who experience liquidity constraints in which short-term loans may serve as a stop-gap between paychecks (Stegman 2007). As a result, they tend to cluster in areas with higher shares of lower-income households (Burkey and Simkins 2004; Gallmeyer and Roberts 2009).

The spatial concentration of high-interest lenders near financially vulnerable populations can compound socioeconomic disadvantage within communities and households (Friedline, Despard, and West 2017; Gallmeyer and Roberts 2009; Melzer 2011). Reducing exposure has been an important component of many state policy efforts (see, e.g., Barth et al. 2011). By examining the MLA in tandem with broader state policy efforts, I contribute to this policy work by examining whether and under what conditions targeted policy for vulnerable populations is more effective in reducing exposure, relative to more universal policy efforts.

Military Servicemembers & Payday Lending

The geographic concentration of military servicemembers with low but steady paychecks have been a draw for payday lenders. High-interest lending companies see military communities as good business locations and have disproportionately clustered near military bases (Carrell and Zinman 2010; Graves and Peterson 2005). The ubiquity of payday lenders near military bases created a troubling situation for the DoD, which worried that servicemembers could worsen their financial situations by using such services (Department of Defense 2006). The DoD urged Congress to take action, which resulted in the MLA and its landmark interest rate cap for loans made to active duty servicemembers.

The “bears on a trout stream” metaphor, coined by Graves and Peterson (2005) and echoed in DoD testimony (Petraeus 2013), underscored that the military perceived both the loan products and the physical clustering of payday lenders as threats to the financial wellbeing of servicemembers. In seeking protections, the DoD devoted an entire section of their report to Congress to their concerns about the spatial proximity and prevalence of payday lenders and other high interest lenders (Department of Defense 2006:10-22). This concern about physical proximity aligns with research showing that an increase in the number of alternative financial service providers within a community is associated with increases in the likelihood and frequency of use of the products, especially among lower-income households (Friedline and Kepple 2016; Melzer 2011). Yet, to date there has not been a causal assessment of whether the original or revised MLA was successful in reducing the number of high-interest lenders near bases.

Data and Method – 2007 MLA

To examine the geographic effects of the MLA, I take advantage of state-level variation in payday lending laws. With the exception of the federally mandated MLA, payday lending is primarily regulated at the state-level and variations in state laws impact the number of payday lenders operating within each state over time (Barth et al. 2016; McKernan, Ratcliffe, and Kuehn 2013). For this analysis, I study changes in payday lender activity in Colorado, Oregon, and Washington before and after the MLA. Together, these three states provide a strong comparison group. Prior to 2007, they had substantively similar regulatory environments with few payday loan laws. In 2007, they begin to differentiate: Colorado and Oregon enacted policy changes while Washington made no changes (see Table 1). Notably, Oregon mandated a state-wide interest cap of 36% for all consumer loans at the same time that the MLA was introduced.

I combine geographic location data collected from the three states and the Department of Defense with Census data to create a unique dataset that allows me to examine payday lender activity between 2004 and 2009 and account for local socio-economic and demographic conditions. Analysis is at the payday-year level; the final analytic sample results in 8,968 payday storefront-years (2,244 storefronts).

I use a quasi-experimental study design to test the efficacy of the MLA. Because the MLA was federally mandated and applied to all payday lenders across all states, it is not possible to identify a group of payday lenders that does not receive the policy “treatment.” However, it is possible to use heterogeneity in treatment intensity by considering a payday lender’s distance to a military base.

Distance to Nearest Base as Measure of Treatment Intensity. The specifications of the MLA suggest that the law’s effects would intensify for payday lenders located near military bases and be minimal for payday lenders not located near a base because the law only applies to loans for active duty military members and dependents. This is because most servicemembers live on or very near military bases (Bissell 2010), resulting in a higher concentration of military borrowers in these markets.

States as a Second Treatment. Although the focus of the paper is on the federal level MLA, which is expected to primarily affect payday lenders near military bases, I take the opportunity to examine the efficacy of the narrowly-targeted MLA in comparison with the efficacy of two broad state-level policy changes that were also implemented in 2007 (see Table 1).

Model Specification. I combine data across states and estimate a fixed effects linear probability model that also include time-varying socio-economic and demographic factors that may influence payday storefront closures. The specification is as follows:

$$Y_{it} = \beta_1 Post_t + \beta_2 (Dist_i Post_t) + \beta_3 (State_i Post_t) + \beta_4 (Dist_i Post_t State_i) + X_{it} \beta_5 + \alpha_i + \varepsilon_{it}$$

Where Y is predicted probability of closure for payday lender i in time t . $Dist$ represents the distance threshold. Models presented here consider a 5-mile threshold (1 = within, 0 = outside). $Post$ equals one after the 2007 policy treatment, and zero prior. $State$ is a three-level categorical variable with Washington as the reference state. X represents a vector of time-varying tract-level controls to account for changing economic and demographic characteristics for each payday lender location.

Anticipated results. The post-period effect, β_1 , would be positive and significant if there are, all else equal, more closures in the period between 2007 and 2009, relative to 2004 – 2006. If the MLA is effective in reducing the presence of payday lenders near military bases, it is expected that β_2 would be positive and significant, such that likelihood of closures after the policy implementation is higher for payday lenders near military bases, relative to payday lenders elsewhere. It is expected that β_3 will be positive and significant if the broad state-level Oregon or Colorado policy changes induce a disproportionate number of payday lender closures within the state after its implementation, relative Washington. Finally, β_4 is not expected to have significance; there should be no state heterogeneity in the effectiveness of the MLA because it is a federal law that is enforced at the federal level.

Results - 2007 Findings

Table 2 presents the results for the 5-mile threshold model. Figure 1 shows the predicted probabilities of payday lender closures by distance from a military base based on this model. All else equal, there are no substantive or statistical differences in the predicted likelihood of closure based on distance from the military base, indicating that the MLA had no effect on operations. This finding holds when testing 3-, and 10-mile thresholds and when using a continuous measure of distance. Alternative specifications that account for fuzzy distance thresholds, base size, and company-level fixed effects also show no substantive differences in findings.

Figure 2 presents the predicted likelihoods of closure before and after the policy changes by state. The difference between post-treatment probabilities of closure in Oregon and the other two states is striking in magnitude. On average, Oregon payday lenders have a 53% chance of closure between 2007 and 2009, whereas Washington and Colorado payday lenders each have less than a 20% chance. The Colorado law limiting the number of payday loans individuals could take out appeared to induce a small increase in the likelihood of closures, relative to Washington, but the state-wide interest rate cap in Oregon induced a mass exit of payday lenders from the state.

Taken together, the figures highlight the inefficacy of the MLA by placing it in stark contrast to state-wide interest-rate cap in Oregon, which was the most effective policy measure for reducing the number of storefronts. In Oregon, the predicted probability of closure increased dramatically for payday lenders both near and far from military bases because the interest rate cap made payday lender business in the state unviable.

Conclusions/Relevance

The 2007 MLA did not remove the bears from the trout stream; it just extracted a few of their teeth by placing restrictions on a limited set of loan products for active duty servicemembers. In contrast, Oregon's state-wide interest rate cap demonstrated success in reducing Oregonians' exposure to high-interest loans, including military servicemembers living and working there. Together, this suggests that policies seeking to protect financially vulnerable populations may be most effective if laws apply to all consumers.

In next steps, a similar assessment of the 2016 MLA revision will help confirm whether laws that apply to a broader population are better able to protect financially vulnerable populations. While expanding the number loan products covered, the revised 2016 MLA still solely applies to active duty servicemembers and their dependents. This analysis will consider the years 2013-2019 and use a fixed effects approach to assess the efficacy of the new MLA relative to state-level policy changes occur within this period. Additional states for this analysis include California and Virginia (data in-hand).

State and federal regulatory bodies have the ability to set basic lending protections but developing the right solutions to protect vulnerable groups from high-cost credit can be difficult. By assessing the 2007 and 2016 MLA in tandem with broader state policies, this study provides insights on best paths forward for policymakers with regards to the structure and scope of consumer protection for financially vulnerable populations.

Table 1. State Regulatory Environments between 2004 and 2009.

| | Colorado | Oregon | Washington (ref.) |
|--------------------------------|--------------------------------------|--|-----------------------|
| Pre: 2004 - 2006 | APR = 520% | APR = No cap, average 390% | APR = 390% |
| Post: 2007 State Policy Change | Installment loan offer after 4 loans | IR cap of 36% for loans under \$50K + fees | No change |
| Post: 2007 MLA Policy Change | 36% MAPR | 36% MAPR | 36% MAPR |
| Post: 2008 - 2009 | No Additional Changes | No Additional Changes | No Additional Changes |

Table 2. Fixed Effects Models for Likelihood of Payday Storefront Closures across Three States.

| | Coeff. | SE |
|--|---------|------|
| Post-Treatment Period (1= 2007-2009; 0= 2004-2006) | 0.02 | 0.02 |
| Base Distance X Post-Treatment Period (5 mile threshold) | 0.01 | 0.03 |
| State X Post-Treatment Period | | |
| Washington (ref.) | -- | -- |
| Colorado | 0.06** | 0.02 |
| Oregon | 0.44*** | 0.02 |
| Base Distance X State X Post-Treatment Period | | |
| Washington (ref.) | -- | -- |
| Colorado | -0.06 | 0.04 |
| Oregon | -0.12* | 0.05 |
| Time Varying Controls | Y | Y |

N= 8969 storefront-years (2,244 storefronts). Time varying controls include: tract-level log population, log median HH income and share of black and Hispanic households, county-level unemployment.

Figure 1. Pre-Post Change in Predicted Probability of Closure, by Payday Lenders' Distance to Base

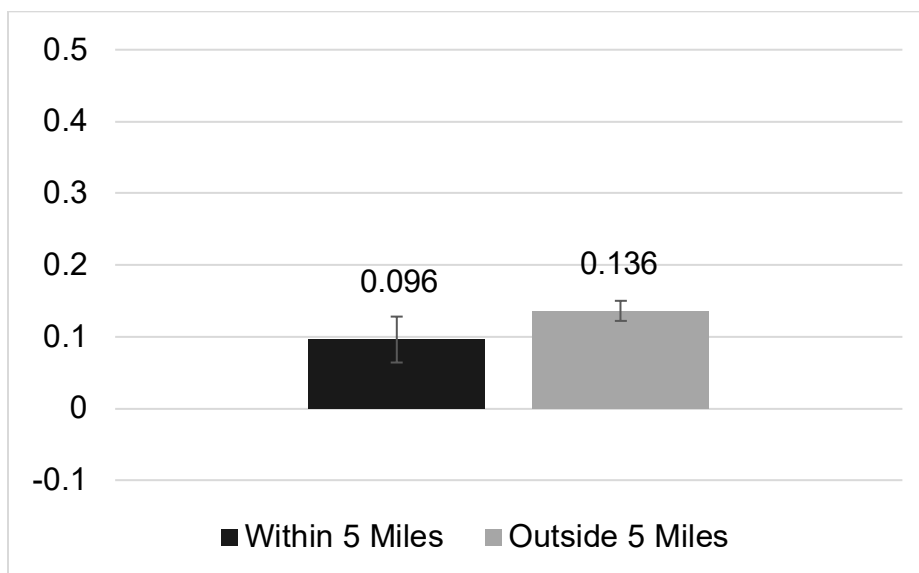
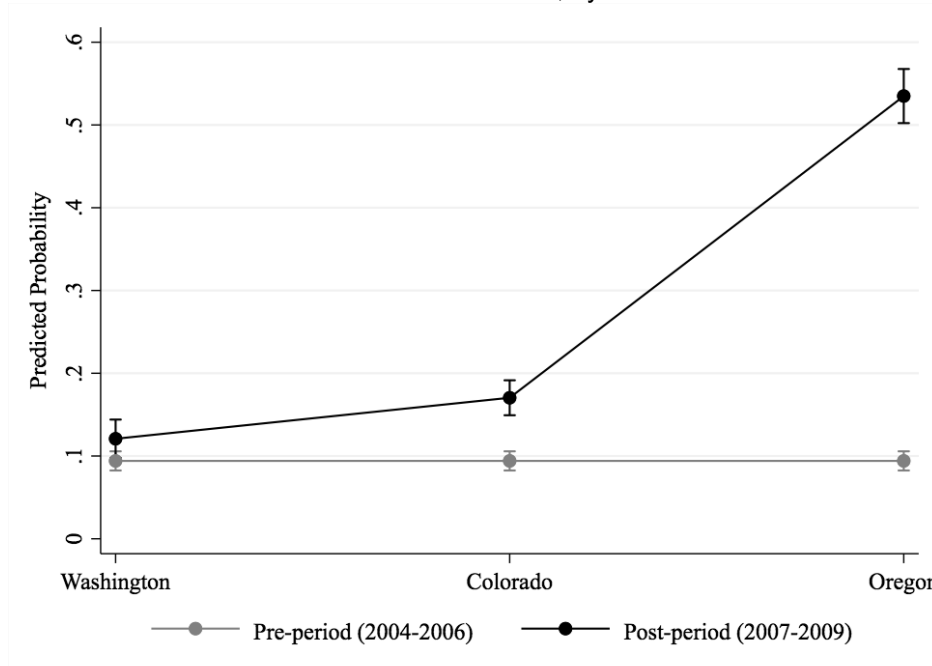


Figure 2. Predicted Probabilities of Storefront Closures, by State before and after 2007 Policy Changes



Notes: Figures based on full model that includes time varying controls. N= 8,968 storefront-years (2,244 storefronts).

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