Are Financial Education Mandates Associated with Use of Alternative Financial Services?

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Alternative financial services (AFS), which include payday loans, auto title loans, pawn shop loans, refund anticipation loans, as well as rent-to-own transactions, are a set of financial products or services offered outside of mainstream financial institutions. Traditional borrowing options are less expensive than fringe borrowing options. However, the prices are not easily comparable because AFS fees are advertised as some dollars per $100 borrowed while traditional borrowing fees are expressed in APRs. AFS loans are also written to be due in two weeks; therefore, most fees translate to APRs around 300 percent, and a standard payday loan charges nearly 400 percent interest (Robb, Babiarz, Woodyard, & Seay, 2015; Federal Trade Commission, 2016). These APRs are at least 10 times the maxima APR charged on credit cards (30 – 33 percent), making AFS one of the costliest financial options. Despite the exorbitant fees, however, approximately three out of 10 Americans reported using these fringe banking services.

Higher proportions of lower income consumers, less financially knowledgeable consumers, underrepresented minorities, and young adults use AFS than their other counterparts (Barth, Hilliard, Jahera, & Sun, 2016; Bertrand & Morse, 2011; Chatterjee, 2013; Friedline & Kepple, 2016; Lusardi & de Bassa Scheresberg, 2013; Robb et al., 2015). These financially vulnerable individuals may gain from interventions impacting AFS use. One intervention that states currently employ are regulating alternative financial services to various degrees, ranging from fee disclosure requirements to an outright prohibition of certain products or services. Another promising intervention is requiring high school students to take personal finance for graduation, since young adults are less financially literate and use AFS more often than their older counterparts (Chatterjee, 2013; Lusardi & Mitchell, 2011). Accordingly, this study addresses this crucial question: do financial education mandates reduce the use of AFS among younger consumers?

Methods

This study employed data on financial education mandates from Urban, Schmeiser and Collins (2015) and a restricted version of the 2012 National Financial Capability Study to investigate whether required high school personal finance courses influence the use of alternative financial services among younger consumers. The sample size in the NFCS is 25,509 respondents, but the sample for this study was restricted to those under age 40 who have completed high school, leaving 7,324 observations. The variation in adoption of mandates across states and across time presents a natural experiment for exploring the relationship between financial education mandates and AFS use. For the purposes of this study, treatment was approximated using current state of residence and respondent's age. Then, logit, negative binomial, and zero-inflated Poisson regressions were run with state dummies to capture any other state characteristics or policies that may be associated with AFS use. All regressions were weighted and clustered at the state level to ensure that the survey design was accounted for and because this is where policy variation occurs.

Policy Implications

Overall, this study suggests that financial education mandates may be associated with less AFS use, particularly payday loans and rent-to-own transactions, among younger consumers. With this finding, policymakers may wish to consider incorporating lessons explicitly discussing AFS in tandem with other credit products. Furthermore, required high school financial education specifically has an impact on vulnerable populations who use more AFS (consumers with lower educational attainment, underrepresented minorities, and females). This suggests that financial education should be emphasized in public policy, especially in underserved areas.

A completed paper will further discuss results, robustness checks, and implications for financial education policy.

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