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Small Dollar Lending

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Pew's Consumer Financial Security Work

Pew Safe Small-Dollar Loans Research Project

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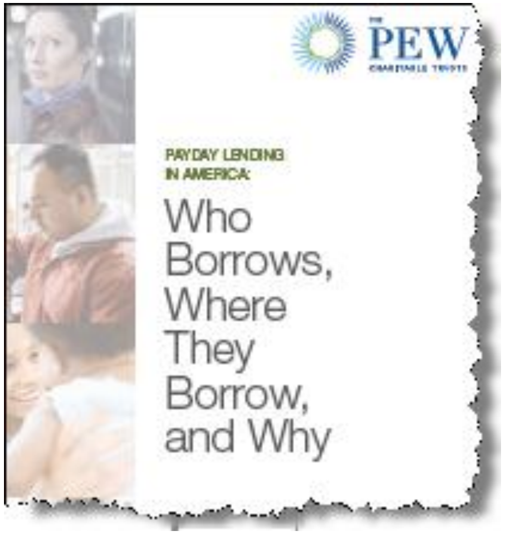


- *Payday Lending in America: Who Borrows, Where They Borrow, and Why (July 2012)*
  - *National survey of payday borrowers (storefront and online), plus nationwide focus groups.*

How Payday and Deposit Advance Loans Work

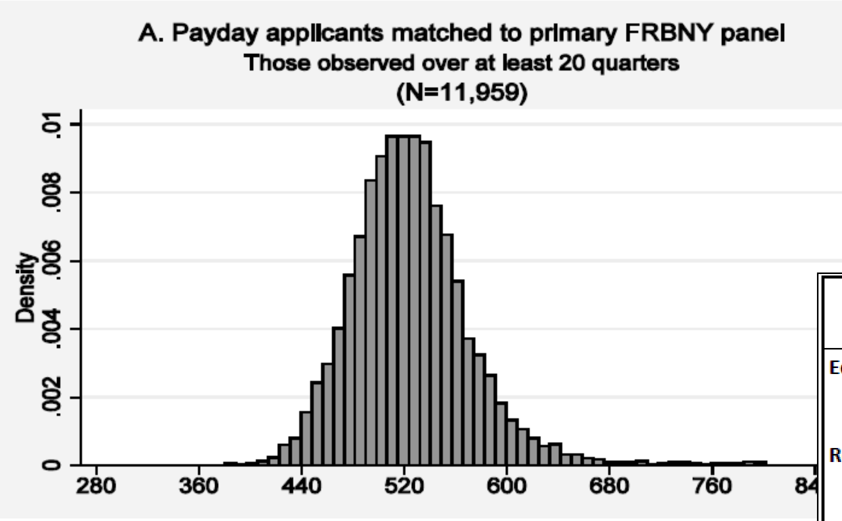
- Borrower has an income source and checking account
  - Post-dated check or electronic authorization to debit account
- Entire loan due on next payday (e.g. two weeks later)
  - If cannot repay entire loan, pays fee to renew or borrows again
- Average loan size $375
  - Fees range per state law: $10 per $100 (261% APR) to $20 per $100 in storefronts (521% APR); or average of $25 per $100 online (652% APR)
  - Some variation for bank Deposit Advance Products (DAPs)

Some Key Questions

- Who uses payday loans / DAP / small-dollar credit?
- Why?
- What is the experience like?
- What are the outcomes?

Who

“[N]early all of our payday loan applicants had a credit record at the time they applied for their first payday loan.” (Bhutta et. al.)



SDC Demographics (CFSI)

	SDC Consumers	Non-SDC Consumers	Overall Population[1]
Education			
% with Bachelor's Degree or Higher	10%	23%	18%
Region			
Northeast	8%	18%	17%
Midwest	21%	24%	22%
South	50%	35%	39%
West	21%	24%	22%
Household Size (Mean)	3.2	2.8	NA
Race/Ethnicity			
White, Non-Hispanic	46%	64%	63%
African-American, Non-Hispanic	29%	11%	14%

EXHIBIT 14:

PAYDAY LOAN BORROWER DEMOGR

Demographic	Percentage of All Payday Borrowers	Percentage of All American Adults
Renters	58	35
Homeowners	41	65
Single	24	31
Living with partner	14	N/A*
Married	33	50
Separated/divorced	25	13
Widowed	4	6
Full-time employed	49	59**
Part-time employed	13	
Unemployed	14	6
Disabled	8	N/A*
Retired	8	23
Homemaker	5	6
Student	3	5

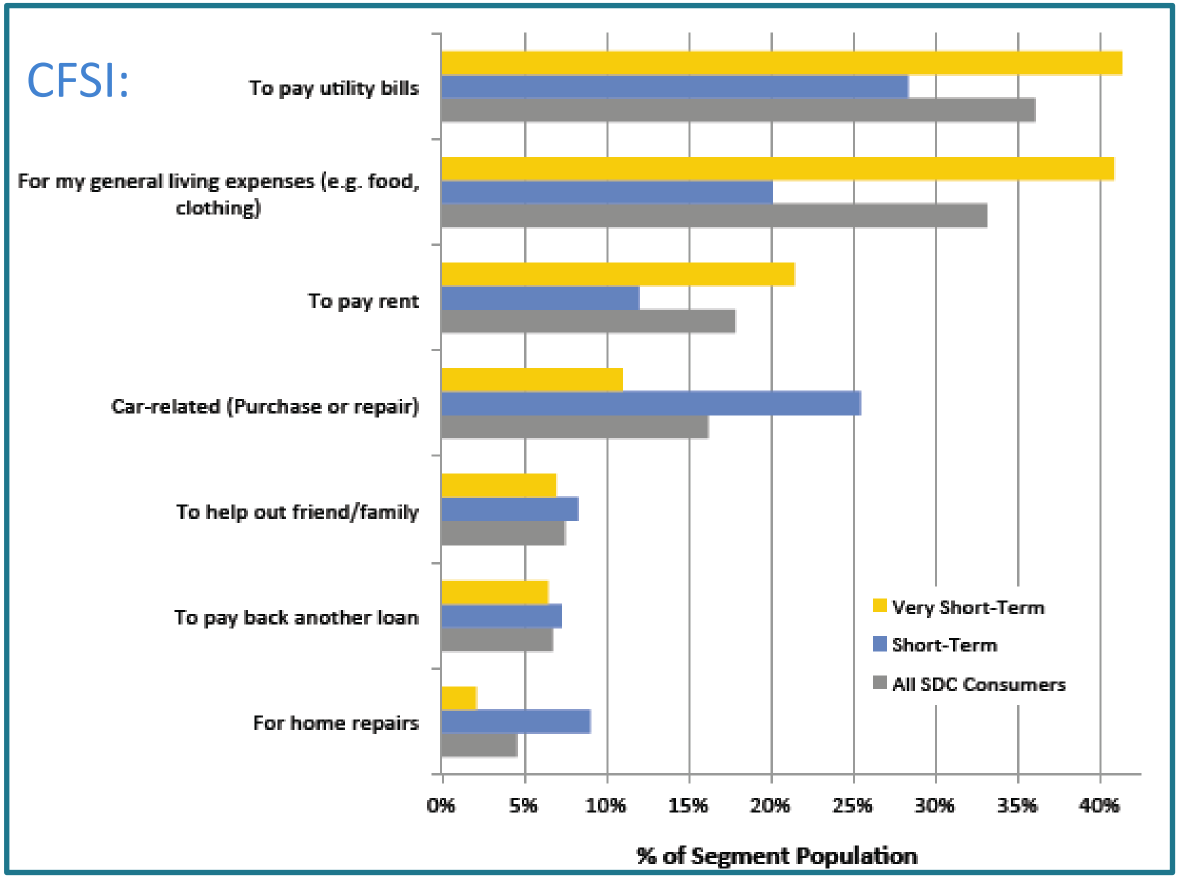
Payday borrower demographics (Pew)

Why – *The Underlying Need*

Payday borrowers (Bhutta et. al):

- Persistently weak credit profiles, permanent cash-flow shortfalls
- Not simply responding to short-term shocks

CFSI:



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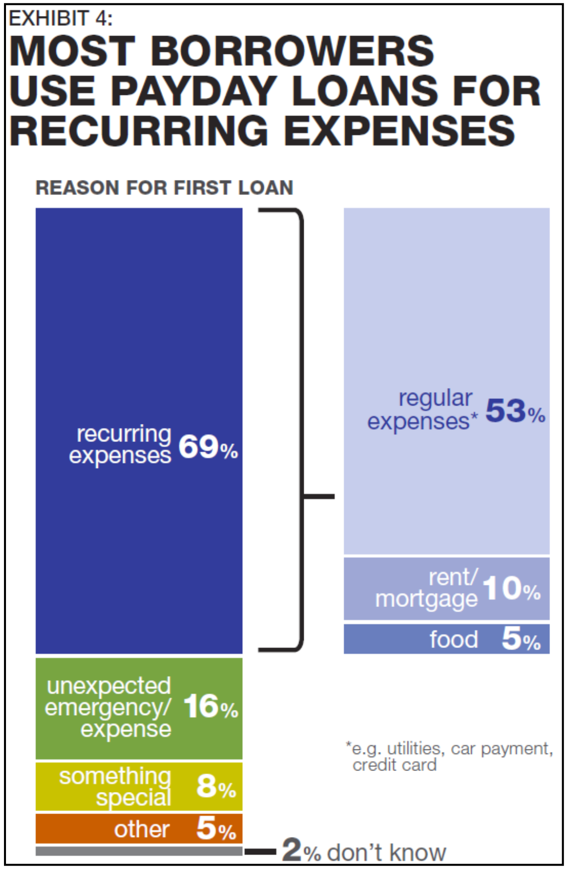


Why – *The Choice to Borrow*

Bhutta et. al: Desperation?!

Credit record information in quarter before first payday loan application

	Payday applicants			General population		
	mean	median	N	mean	median	N
				.0	4	103,766
				13	0	93,912
				75	1	103,766
				14	11,000	78,146
				28	1,586	78,146
				.7	1	103,766
				.1	1	103,606

CFSI:

Chart 3: Reason for Fund Shortage Precipitating SDC Use

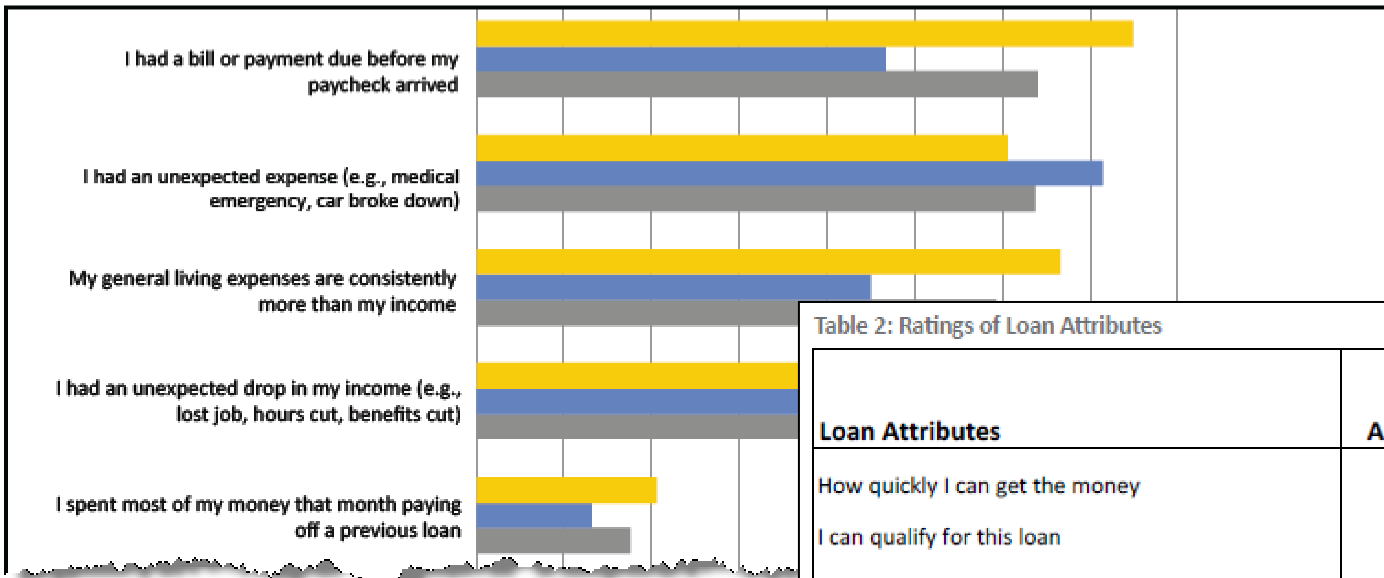


Table 2: Ratings of Loan Attributes

Loan Attributes	Average Rating (Scale o	
	All SDC Consumers	Very Short-Term
How quickly I can get the money	4.4	4.4
I can qualify for this loan	4.4	4.4
Clear terms/knowing exactly what I'll pay	4.3	4.3
Amount I can borrow	4.2	4.2
Term or length of loan	4.1	4.0

Why – *The Choice to Borrow: Possible Frameworks*

- Desperation
  - About 1/3 of borrowers would accept a loan on any terms
- Reliance: Trust in or affinity toward the lender
  - Packaging suggests the loan will be short-term or temporary
  - Comfortable customer service relationships
- Perception
  - Payday / DAP / SDC is “not another bill”
  - Focus on the fee, rather than the whole repayment
  - Confusion (e.g. 15% payday loan fee vs. 15% APR)
- Convenience: “It’s too easy”

Why – *The Choice to Borrow*

Chart 4: Steps Taken in Addition to Borrowing

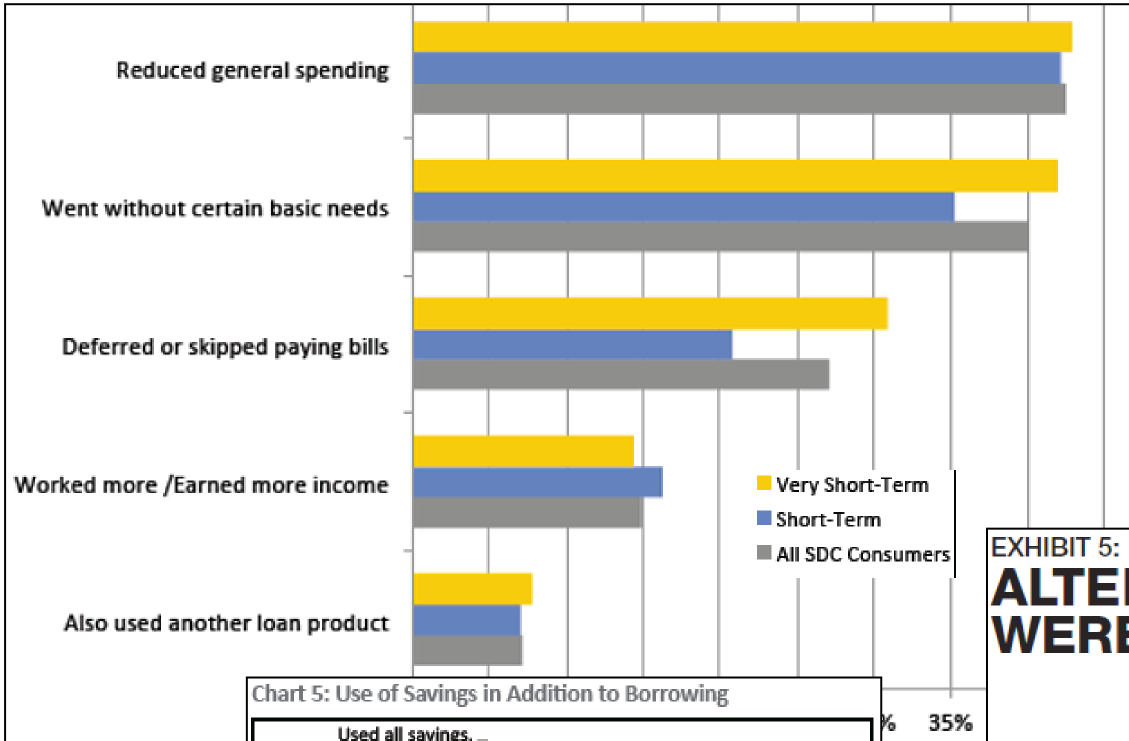
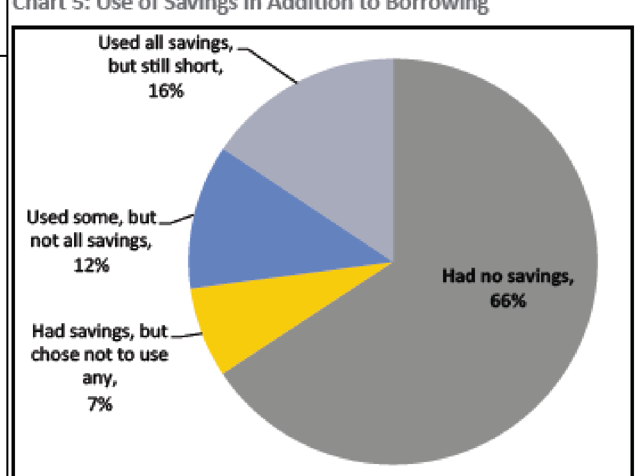
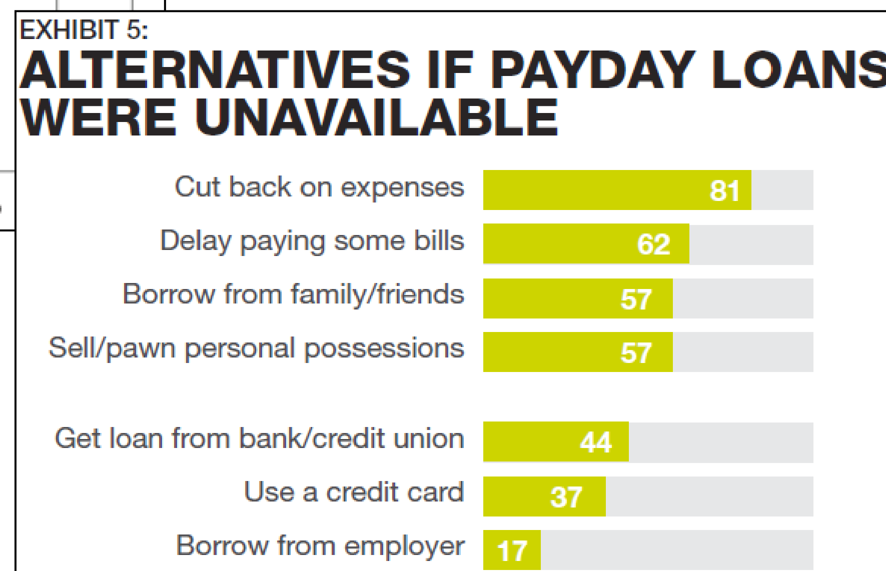


Chart 5: Use of Savings in Addition to Borrowing





What is the Experience Like?

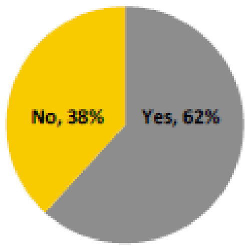
Not Short-Term

- CFSI data shows heavy repeat usage
  - But self-reported data on timely repayment difficult to interpret
- Administrative data overwhelmingly shows that people use payday loans heavily :
  - Average borrower in debt five months during year.
  - 80% of borrowers use 3+ loans per year (97% of all loans).
  - 63% of all loans go to people using 12+ per year.
  - More borrowers use 17+ loans per year than just one.
  - Each year: 13% of loans are borrower's first that year; 76% are renewals or re-borrows w/in one pay period. 11% are new loans more than one pay period later. (CRL)

PAYDAY LOANS

Did you pay the first loan off on time? [1]

(n=305)



If you DID NOT pay off the first loan on time:

(n=117)

What did you do?

Rolled over or extended the loan	86%
Did not pay off the loan (default)	14%

If you rolled over the loan:

(n=100)

Why did you need to rollover or extend the loan?

After paying living expenses, I didn't have er enough money left over	60%
My income was less than anticipated	40%
I had an unexpected expense or emergency	12%
Another reason	2%

How many times did you rollover the loan?

1-2 times	43%
3-5 times	30%
6+ times	26%
No Answer	1%
Average # of rollovers	5.1

What is the Experience Like?

Convenient / Accessible

- Top two factors: How quickly, whether I can qualify (CFSI)
- About 80% of first-time applicants approved (Bhutta et. al.)

Customer service drives good feeling

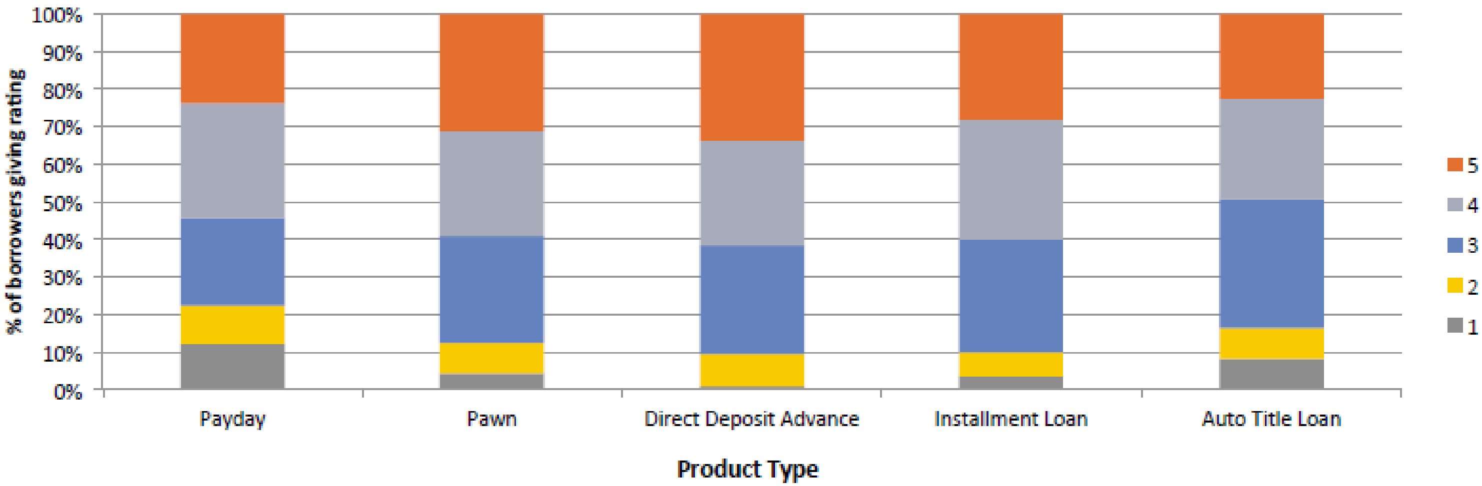
“They always…speak to you by first name and say, hello, how you doing when you first come in the store, and they’re good with remembering your name and your face.”

Fast relief, but…

“I do like payday loans… (but) they do take advantage because, you know, they do know that you need the money, and they know that they got you.”

What is the Experience Like?

Overall, How Satisfied Were You With This Loan?
Scale of 1 (Not Satisfied) to 5 (Very Satisfied)



	Very Short-Term			Short-Term	
Expectations	Payday Loan	Pawn Loan	Direct Deposit Advance	Installment Loans	Auto Title Loan
Cost					
% reporting cost of loan was **more** than expected	40%	19%	15%	26%	43%
% reporting cost of loan was **less** than expected	10%	14%	18%	6%	17%
Time to Repay					
% reporting it took **more** time than expected to repay the loan	32%	29%	20%	17%	32%
% reporting it took **less** time than expected to repay the loan	13%	15%	16%	17%	19%
Likelihood to Use Loan Product Again					
Would you use the product again?					
Yes, without hesitation	33%	44%	53%	45%	22%
Maybe, if I have no better options	44%	44%	41%	39%	55%
No	22%	10%	5%	14%	22%

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The average experience is very different than packaging suggests

Packaging:

Short-term loan

To cover small, often unexpected expenses.

Designed to solve temporary cash-flow problems

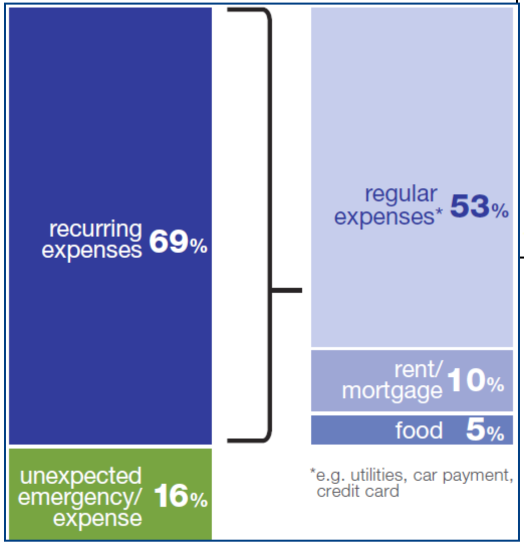
Not intended for long-term use

Experience:

Average Payday Borrower:
8 to 11 loans per year
$520 in fees (on $375 extension of credit)
Indebted five months during the year

When looking across the entire year, the total number of loans or extensions and amount of time spent in debt is particularly disturbing.

35% of direct deposit advance borrowers reported using the product again in the month after their original loan. Such repeat use may indicate that consumers are borrowing to cover basic living expenses after automated repayments claim needed funds, effectively creating a cycle of debt.



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Help or harm?

> Whether payday loan access hurts or harms consumers is an empirical question. Standard economic theory suggests that consumer credit—even high-interest credit—can increase utility by facilitating consumption-smoothing. Indeed, the payday loan industry asserts that the loans help customers cope with short-term shocks that arise between paychecks. Many have a different view; thirteen states have banned payday lending and nineteen states have banned the process of rolling over a loan.[2]

This paper shows that on net, payday loan borrowers' credit score outcomes are neither improved nor harmed by payday credit. Is that a good result or a bad result? How compares to other SDL (installment, subprime credit card)?

Data shows that for a small number of people – perhaps 1 in 5 borrowers – there appears to be some time shifting / consumption smoothing occurring. What about the 4 in 5 who use 3+ loans annually, or those who use 12+ loans annually and make up 63 percent of loan volume?

What Are the Outcomes?

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Not helping. Harm?

10-year credit history. These data reveal that payday loan applicants have persistently very weak credit profiles – 95 percent of payday loan applicants are in the bottom quartile of the population distribution of long-term average credit scores. These results are more consistent with the notion that such consumers suffer from long-term financial problems and permanent cash-flow shortfalls. In other words, payday lending per se may not be the source of financial distress for the millions of consumers using them, as many policymakers and consumer advocates seem to believe.

We also find, using a regression discontinuity design, that the path of traditional credit scores over time following applying for a payday loan for the first time does not differ significantly between those just barely accepted or rejected to borrow on payday loans. Also, credit score components (e.g. number of recent collection accounts) are also similar for both groups after application. These results suggest that access to payday loans does not have large effects (positive or negative) on households' financial well-being.

Some Observations

- Bhutta et. al.
  - Insightful comparison pool, broad outcome measure (credit score)
  - Payday loans not helping… nor the root cause of financial distress
  - Want to see more outcomes tested beyond mainstream credit profile
  - Analyze outcomes for heavy users versus casual users?
- CFSI
  - Fascinating comparison of multiple products / types, especially on satisfaction and expectations
  - Good exploration of underlying reason for funds shortage
  - Self-reported data about usage can offer optimistic picture because it does not capture re-borrowing

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A Question

Bank Deposit Advance Products (DAP)

- DAP loan model generally mimics payday: lump-sum, due quickly
- Overwhelming evidence that payday model results in heavy repeat usage (with low default rates)
  - Borrowers cannot afford to pay in full *and* meet other financial obligations.
  - But they *can* afford to pay the finance charge.
- Rebuttable presumption that DAP suffers from the same (large) disparity between packaging and experience that payday does?
  - There is no evidence that DAP borrowers would be better able to afford the lump-sum repayment, while there is evidence that they experience heavy repeat usage.