Consumer Financial Services Webinar Series

Webinar #5:

Better Options for Consumers: Affordable, Responsible Products in the Consumer Finance Marketplace

February 11, 2016  1:00 – 2:00 PM ET
Presenters

• Lauren Stebbins
  Senior Associate, Strategic Initiatives
  Opportunity Finance Network

• Tanya Ladha
  Senior Manager
  Center for Financial Services Innovation

• Clinton Key
  Research Officer, Savings and Financial Security
  The Pew Charitable Trusts

• Alex Horowitz
  Research Manager, Small-Dollar Loans
  The Pew Charitable Trusts
Agenda

- NEXT Awards and Consumer Financial Services

- Consumer Finance Landscape
  - Challenges for today’s consumers
  - Financial shocks and well-being
  - Payday and auto loans

- Better Options in the Consumer Finance Marketplace
  - Product Innovations
  - Implications for products and policy
  - Product features and sustainability

- Q&A
Reminders

• This webinar is being recorded and will be posted at nextawards.org/webinars

• During the webinar, you can type your questions into the GoToWebinar question box
2016 NEXT Awards

- Year-long awards program
- Awarded more than $70 million since 2007
- 2012-2016 theme of expanding coverage
  - 2016 subtheme: consumer financial services
- Goals
  - Take CDFIs to the next level of growth and impact
  - Increase visibility of CDFIs and the work they do
- Combines financial support, visibility, learning, and sharing
2016 NEXT Awards

• **Key dates**
  – Application open: 1/21/16
  – Application close: 3/2/16

• **Two Awards**
  – NEXT Opportunity Award
    • $7 million for up to 4 CDFIs
    • Combination of debt and grant for strategies ready to implement within 6 months
  – NEXT Seed Capital Award
    • $100,000 grant for 1 CDFI for a developing strategy

• **Intent to Apply**
  – Please send e-mail to info@nextawards.org by 2/22/16 if you plan to apply
  – indicate which award you plan to apply for
For More Information

- **nextawards.org**
  - Application guidelines
    - Eligibility and selection criteria
  - Online Application
  - Recording of information session

- **Webinar series** to support the theme of consumer financial services
CONSUMER CHALLENGES

Credit: Need and Access
### Need Case

<table>
<thead>
<tr>
<th>Need Case</th>
<th>% of Borrowers*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unexpected Expense</td>
<td>32%</td>
</tr>
<tr>
<td>Misaligned Cash Flow</td>
<td>32%</td>
</tr>
<tr>
<td>Exceeding Income</td>
<td>30%</td>
</tr>
<tr>
<td>Planned Purchase</td>
<td>9%</td>
</tr>
</tbody>
</table>

*Includes multiple reporting of credit needs.

"Know Your Borrower: The Four Need Cases of Small-Dollar Credit Consumers," CFSI, 2013
Lack of Access to Formal Credit

53 million
U.S. consumers do not have traditional credit scores due to thin or non-existent credit files

A good credit rating saves the average borrower an estimated $250,000 in interest over a lifetime.

Source: FiveThirtyEight
Informal Borrowing

46% of SDC users have borrowed from family and friends in the last 12 months

15% of SDC users would borrow from family or friends in an emergency

Informal loans offer flexibility and convenience

Source: CFSI
CONSUMER CHALLENGES

Income Volatility
1 of 3 Americans encounter significant variation in their income—over half of these Americans are employed full-time.

3 of 4 SDC users juggle monthly bill payments.

CONSUMER CHALLENGES

The Role of Savings
49% of SDC users do not save.

66% of SDC users have less than $1,000 in liquid assets.

Source: CFSI
Financial Shocks and Financial Well-being

February 11, 2016
Clinton Key
Officer, Research
Savings and Financial Security
60% of households experienced a financial shock last year

The median cost of households’ most expensive shocks was $2,000

<table>
<thead>
<tr>
<th>25th Percentile</th>
<th>Median</th>
<th>75th Percentile</th>
</tr>
</thead>
<tbody>
<tr>
<td>$800</td>
<td>$2,000</td>
<td>$6,000</td>
</tr>
</tbody>
</table>
More than half of households struggled to “make ends meet” after their most expensive financial shock

### Most Households Struggled Financially After a Shock

Percentage reporting difficulty as a result of a shock, by demographic group

<table>
<thead>
<tr>
<th>Generation</th>
<th>Over 60% Struggling</th>
</tr>
</thead>
<tbody>
<tr>
<td>Millennials</td>
<td>69%</td>
</tr>
<tr>
<td>Gen X</td>
<td>59%</td>
</tr>
<tr>
<td>Boomer</td>
<td>51%</td>
</tr>
<tr>
<td>Silent</td>
<td>35%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Annual household income</th>
<th>Over 60% Struggling</th>
</tr>
</thead>
<tbody>
<tr>
<td>$85K or more</td>
<td>35%</td>
</tr>
<tr>
<td>$50K-$85K</td>
<td>52%</td>
</tr>
<tr>
<td>$25K-$50K</td>
<td>68%</td>
</tr>
<tr>
<td>Under $25K</td>
<td>73%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Race</th>
<th>Over 60% Struggling</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hispanic</td>
<td>62%</td>
</tr>
<tr>
<td>Black</td>
<td>62%</td>
</tr>
<tr>
<td>White</td>
<td>53%</td>
</tr>
<tr>
<td>Other race</td>
<td>60%</td>
</tr>
</tbody>
</table>

All: 55%

Notes: Respondents to the Survey of American Family Finances were asked about their most expensive shock, “Did this event make it harder for your household to make ends meet for a while, or did it not affect your household’s ability to make ends meet?” Answer choices were: “It made it harder to make ends meet” and “It did not affect our ability to make ends meet.”

Source: Survey of American Family Finances
© 2015 The Pew Charitable Trusts

www.economicmobility.org
The impact of shocks was long lasting

All households with a destabilizing shock

<table>
<thead>
<tr>
<th>Duration</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>A few weeks</td>
<td>6%</td>
</tr>
<tr>
<td>About a month</td>
<td>12%</td>
</tr>
<tr>
<td>A few months</td>
<td>24%</td>
</tr>
<tr>
<td>Six months or longer</td>
<td>10%</td>
</tr>
<tr>
<td>Still not normal</td>
<td>50%</td>
</tr>
</tbody>
</table>

Households who reported having recovered

<table>
<thead>
<tr>
<th>Duration</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>A few weeks</td>
<td>10%</td>
</tr>
<tr>
<td>About a month</td>
<td>22%</td>
</tr>
<tr>
<td>A few months</td>
<td>49%</td>
</tr>
<tr>
<td>Six months or longer</td>
<td>18%</td>
</tr>
</tbody>
</table>

54% of those who haven’t recovered experienced their shock 6+ months prior to the survey
Typical savings balances (overall)

<table>
<thead>
<tr>
<th>Percentile</th>
<th>25\textsuperscript{th}</th>
<th>50\textsuperscript{th}</th>
<th>75\textsuperscript{th}</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dollars</td>
<td>$400</td>
<td>$3,800</td>
<td>$17,000</td>
</tr>
<tr>
<td>Days of income</td>
<td>4</td>
<td>23</td>
<td>90</td>
</tr>
</tbody>
</table>
Payday and Auto Title Loans

www.pewtrusts.org/small-loans
How Payday Loans Work

• Packaged as “short-term” loan for “temporary needs”
  – Obtained from storefronts and the Internet

• Little to no underwriting
  – Borrower has an income source and checking account; no history of fraud

• Lender can debit bank account to collect (deferred presentment)

• Short repayment period, tied to borrower pay cycle
  – If borrower cannot pay in full, pays fee to renew, or borrows again

• Avg. loan is $375
  – Fee per 2 weeks: $55 store, $95 online, $35 bank (now discontinued)
Renewing is Affordable, But Paying Off is Not

Average borrower can afford (per two weeks)
$50

Amount Due in Two Weeks to Pay Off a Loan of $375
$430 (principal + fee of $55)

OR

Amount to Renew or Re-borrow Loan for Two More Weeks, Without Paying Down Principal
$55

www.pewtrusts.org/small-loans
Extended, Consecutive Usage is the Norm

• Typical loan consumes 36% of avg. borrower’s paycheck
  – Typical borrowers can afford 5% of paycheck

• Unaffordable payment leads to repeat borrowing, with avg. borrower in debt for half the year

• Consecutive usage is the norm
  – 80% of loans originate within 14 days of a previous loan

• Average borrower pays $520 in fees per year to repeatedly borrow $375 in credit over half the year
  – 12 million consumers pay more than $7 million in fees annually
## How much does a $500 payday loan cost for 2 weeks?

<table>
<thead>
<tr>
<th>State</th>
<th>Advance America</th>
<th>Ace Cash Express</th>
<th>Check Into Cash</th>
<th>Check ‘n Go</th>
</tr>
</thead>
<tbody>
<tr>
<td>Colorado</td>
<td>$22</td>
<td>$22</td>
<td>$22</td>
<td>---</td>
</tr>
<tr>
<td>Florida</td>
<td>$55</td>
<td>$55</td>
<td>$53</td>
<td>$55</td>
</tr>
<tr>
<td>Michigan</td>
<td>$65.45</td>
<td>---</td>
<td>$65.45</td>
<td>$65.45</td>
</tr>
<tr>
<td>Kansas</td>
<td>$75</td>
<td>$75</td>
<td>$75</td>
<td>$75</td>
</tr>
<tr>
<td>Alabama</td>
<td>$87.50</td>
<td>$87.50</td>
<td>$87.50</td>
<td>$87.50</td>
</tr>
<tr>
<td>Texas</td>
<td>$102</td>
<td>$127</td>
<td>$102</td>
<td>$127</td>
</tr>
</tbody>
</table>

The prices charged reflect fee limits in all states except Texas, which has no limit.
• Title lenders operate more than 8,000 stores in 25 states

• 2.5 million borrowers annually, paying $3 billion in fees

• Average borrower:
  – Usually has clear title to the car (no outstanding car loan)
  – Has income of about $30,000 per year
  – Often struggles to make ends meet
  – Spends $1,200 in fees annually to repeatedly borrow $1,000 in credit
Prepaid cards

- Prepaid cards let consumers transact electronically
- 9% of adults using; 72% of users also have a checking account

**Consumers' Reasons for Using Prepaid Cards**

<table>
<thead>
<tr>
<th>Reason</th>
<th>Major reason (%)</th>
<th>Total reason (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control spending</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Avoiding credit card debt</td>
<td>52</td>
<td>67</td>
</tr>
<tr>
<td>Helping you not spend more money than you actually have</td>
<td>51</td>
<td>66</td>
</tr>
<tr>
<td>Dividing your spending into budget categories</td>
<td>30</td>
<td>54</td>
</tr>
<tr>
<td>Control fees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Avoiding overdraft fees</td>
<td>46</td>
<td>63</td>
</tr>
<tr>
<td>Avoiding check cashing fees</td>
<td>38</td>
<td>57</td>
</tr>
<tr>
<td>Make purchases</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Making purchases online and other places that don't accept cash</td>
<td>51</td>
<td>72</td>
</tr>
</tbody>
</table>
Product Innovations
Creating Savings Opportunities

Income Smoothing

Even

activehours
“It is critical that high-quality SDC products support borrowers with building their credit. All lenders should report payment histories on all credit products to at least the three major credit bureaus.”
A Snapshot of Quality and Innovation Among Small-Dollar Credit Installment Lenders, CFSI, 2015
Promote Long-term Success
Promote Long-term Success
Implications for products and policy

February 11, 2016
Clinton Key
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Savings and Financial Security
Product and Policy Implications

- Households benefit from automatic mechanisms to generate savings.
- Access to savings in times of need may reduce hardship and maximize financial control.
- Families need targeted help understanding the ebbs and flows of their income and expenses.
- Policies and programs that focus on specific accounts may not align with families’ needs and goals.
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Forthcoming CFPB Small-Loan Rules Could Provide an Opportunity for CDFIs

www.pewtrusts.org/small-loans
Fixed and variable costs of issuing small-dollar loans

**Banks’ & CUs’ advantages:** already serving these customers, cover overhead already, lower losses, lower cost of funds, automation, service checking account, banking platform

<table>
<thead>
<tr>
<th></th>
<th>Storefront Lenders</th>
<th>Online Lenders</th>
<th>Banks/CUs</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ability to cross-sell</strong></td>
<td>Low</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td><strong>Overhead Costs</strong></td>
<td>2/3 of revenue</td>
<td>2/5 of revenue</td>
<td>covered</td>
</tr>
<tr>
<td><strong>Acquisition Costs</strong></td>
<td>Store draws customers</td>
<td>$125/lead, $10/click</td>
<td>existing customers</td>
</tr>
<tr>
<td><strong>Cost of Funds</strong></td>
<td>5-10% interest rate</td>
<td>5-20% interest rate</td>
<td>1-2% interest rate</td>
</tr>
<tr>
<td><strong>Loan Charge-offs</strong></td>
<td>Moderate</td>
<td>High</td>
<td>2-6% of dollars lent</td>
</tr>
</tbody>
</table>
Survey Results: Loan Charges

Americans View Current Payday Installment Loan Charges as Unfair
But 3 in 4 say that an $80 fee is fair for a $500 loan paid back over 4 months

Similar to some current payday installment loans

$500 loan for a fee of $1,000 paid back over 16 months
- Fair: 13%
- Don’t know/refused: 84%
- Unfair: 3%

$500 loan for a fee of $450 paid back over 5 months
- Fair: 17%
- Don’t know/refused: 80%
- Unfair: 3%

Hypothetical bank small loan

$500 loan for a fee of $80 paid back over 4 months
- Fair: 76%
- Don’t know/refused: 20%
- Unfair: 4%
Sustainable elements of small-loan programs

• Here are examples of small-loan elements in practice

• Simple, low-cost screening, origination, and servicing
  – Q-Cash Financial (Filene Research Institute, WASECU)

• Affordable installment payments around 5% of income
  – Kinecta Federal Credit Union, Spring Bank

• Achieves scale with mutually sustainable prices
  – St. Louis Community FCU, OneDetroit CU, Oportun

• Low-cost acquisition through employers
  – Sunrise Banks, Community Dev. Corp. of Brownsville

*Note: Pew does not endorse specific products*
Q&A

Type your question into the GoToWebinar question box