Wells Fargo NEXT Awards for Opportunity Finance

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

Wells Fargo NEXT Awards for Opportunity Finance

- 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

Wells Fargo NEXT Awards for Opportunity Finance

- 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

Four Need Cases of Small-Dollar Credit Users

Need Case	% of Borrowers*
Unexpected Expense Borrowers access credit infrequently for larger expenses related to an unexpected or emergency event	32%
Misaligned Cash Flow Borrowers access smaller credit amounts frequently to pay bills when income and expenses are misaligned	32%
Exceeding Income Borrowers' expenses regularly exceed income – among the heaviest users of credit	30%
Planned Purchase Borrowers use SDC to make a relatively large, planned purchase, often related to a personal asset	9%

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

*Includes multiple reporting of credit needs.

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

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

Source: Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2013."

CONSUMER CHALLENGES

The Role of Savings

Ability to Save

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

PEW

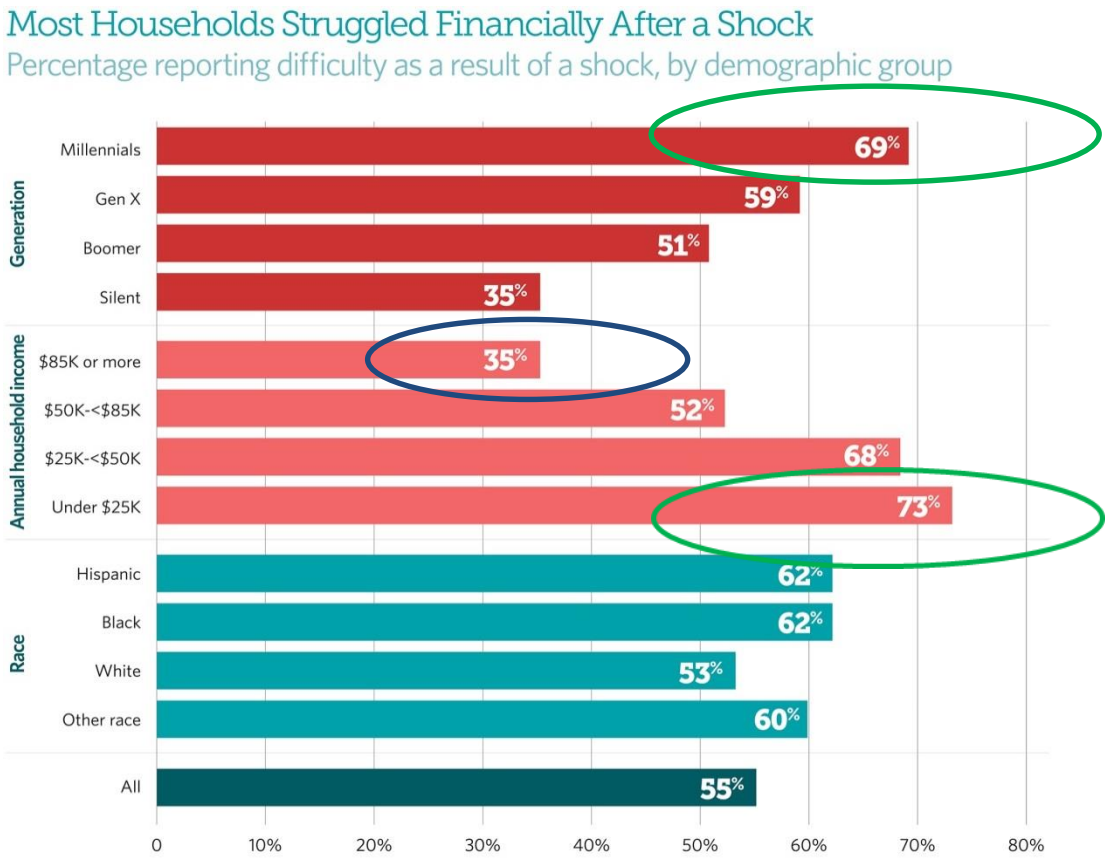
60% of households experienced a financial shock last year

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

25th Percentile	Median	75th Percentile
$800	$2,000	$6,000

PEW

More than half of households struggled to "make ends meet" after their most expensive financial shock



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

The impact of shocks was long lasting

All households with a destabilizing shock

A few weeks	6%
About a month	12%
A few months	24%
Six months or longer	10%
Still not normal	**50%**

54% of those who haven't recovered experienced their shock 6+ months prior to the survey

Households who reported having recovered

A few weeks	10%
About a month	22%
A few months	49%
Six months or longer	18%

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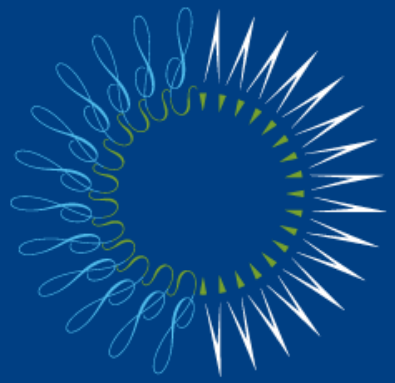
Typical savings balances (overall)

	Liquid savings		
Percentile	25th	50th	75th
Dollars	$400	$3,800	$17,000
Days of income	4	23	90



THE PEW CHARITABLE TRUSTS

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

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

A Market Lacking Price Competition

THE PEW CHARITABLE TRUSTS

How much does a $500 payday loan cost for 2 weeks?

	Advance America	Ace Cash Express	Check Into Cash	Check 'n Go
Colorado	$22	$22	$22	---
Florida	$55	$55	$53	$55
Michigan	$65.45	---	$65.45	$65.45
Kansas	$75	$75	$75	$75
Alabama	$87.50	$87.50	$87.50	$87.50
Texas	$102	$127	$102	$127

The prices charged reflect fee limits in all states except Texas, which has no limit.

Overview of Title Loan Market

- 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

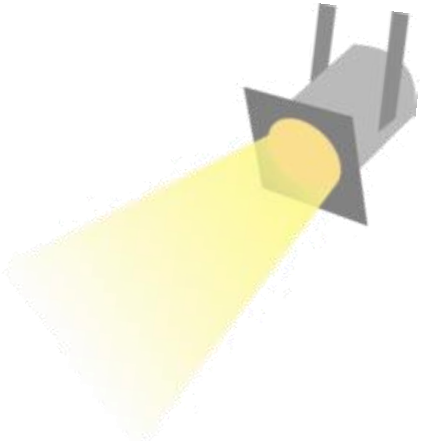
- Prepaid cards let consumers transact electronically
- 9% of adults using; 72% of users also have a checking account

Consumers' Reasons for Using Prepaid Cards

	Major reason (%)	Total reason (%)
Control spending		
Avoiding credit card debt	52	67
Helping you not spend more money than you actually have	51	66
Dividing your spending into budget categories	30	54
Control fees		
Avoiding overdraft fees	46	63
Avoiding check cashing fees	38	57
Make purchases		
Making purchases online and other places that don't accept cash	51	72

Product Innovations

Creating Savings Opportunities



Borrow and Save

Filene Research Institute

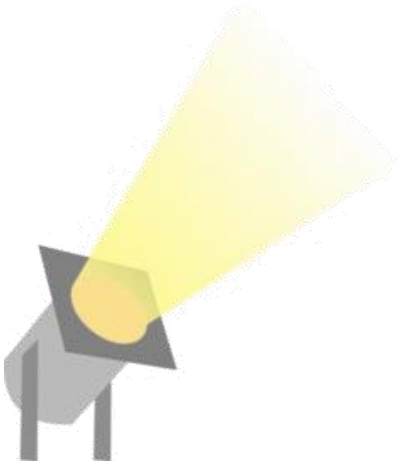
Federation
Credit Unions United to Serve the Underserved

"A Snapshot of Quality and Innovation Among Small-Dollar Credit Installment Lenders", CFSI, 2015.

Income Smoothing

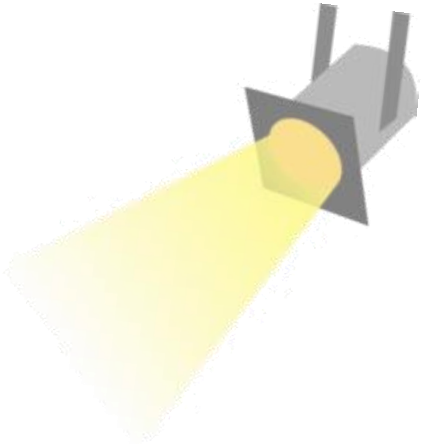
Even

activehours



"FinLab Snapshot: Solutions to Manage Household Cash Flow", CFSI, 2015.

Inclusive Underwriting



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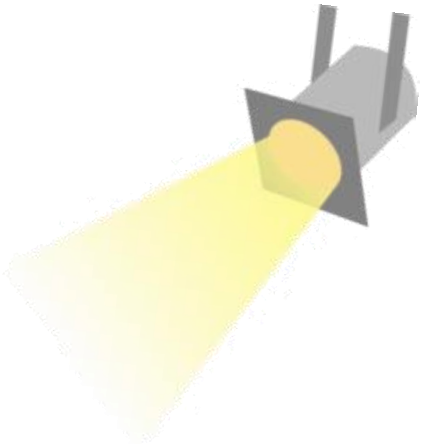
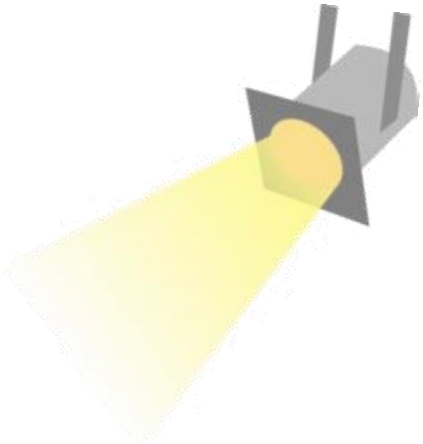


GuarantyBank
You're busy. Bank easy.

"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



enova™

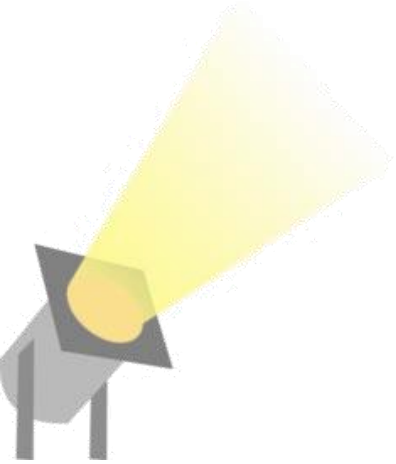
OPORTUN™

Promote Long-term Success

RISE

ASCEND CONSUMER FINANCE

LendUp



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Implications for products and policy

February 11, 2016

Clinton Key
Officer, Research
Savings and Financial Security

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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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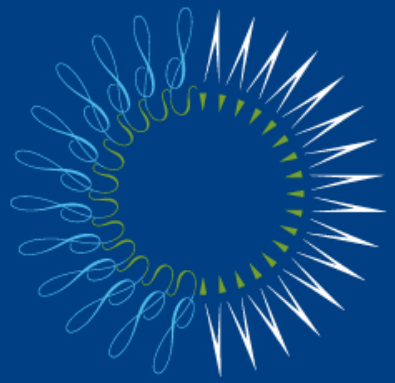

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Forthcoming CFPB Small-Loan Rules Could Provide an Opportunity for CDFIs

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

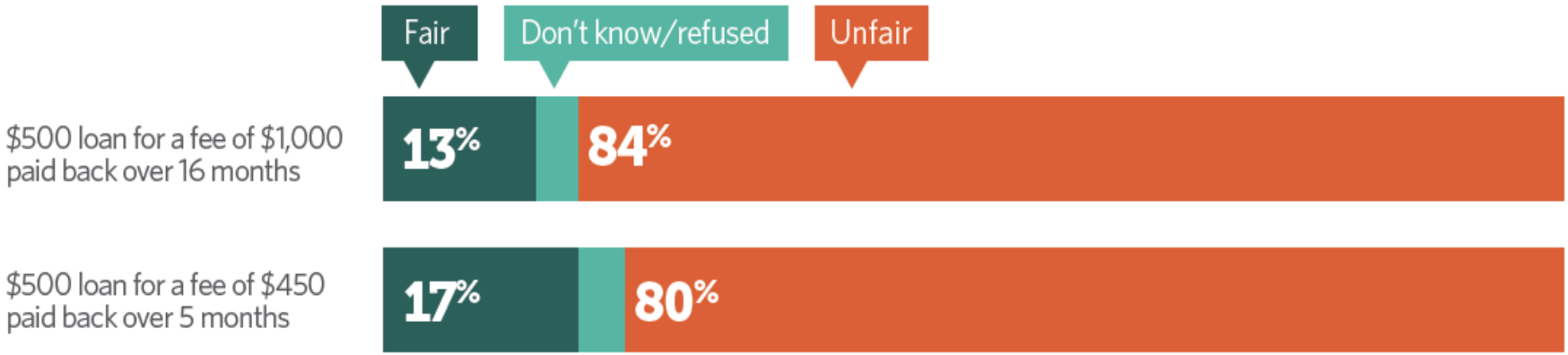
	Storefront Lenders	Online Lenders	Banks/CUs
Ability to cross-sell	Low	Low	High
Overhead Costs	2/3 of revenue	2/5 of revenue	covered
Acquisition Costs	Store draws customers	$125/lead, $10/click	existing customers
Cost of Funds	5-10% interest rate	5-20% interest rate	1-2% interest rate
Loan Charge-offs	Moderate	High	2-6% of dollars lent

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



Hypothetical bank small loan

www.pewtrusts.org/small-loans

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

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Type your question into the GoToWebinar question box