Center for Financial Security
Family Financial Security Webinar Series
February 14, 2012

Payday Lending

Sponsored by a grant from the UW-Madison School of Human Ecology Beckner Endowment
What Difference Does a Week Make? The Effect of Payday Loan Durations

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UW Madison Faculty Affiliate:
Center for Financial Security and Institute for Research on Poverty

This research is joint with Susan Carter and Paige Skiba from Vanderbilt University
Different perspectives on pay-day lending

Provides quick and accessible credit when needed.

High APR can lead to debt spiral as loans rolled over

Regulation

Ban pay-day loans
Cap interest rates
Cap loan amounts
Limit rollovers
Minimum durations

Stronger
Weaker
What is the effect of longer loan durations?

LOWERS EFFECTIVE INTEREST RATE
- All else equal longer durations imply lower annual interest costs.

MAY REDUCE FREQUENCY OF LOAN ROLLOVER
- More time to save and have funds to repay loan.

Reason for payday loan = Temporary shock to income or spending needs

Reason for payday loan = chronic debt issues caused by self-control problems, inattention, etc...

Yes ??
Our Data

OVERVIEW OF LARGE DATA SET
– Provided by a pay-day loan company active in many states.
– All transactions at their stores between 2002 and 2004.
– Observe full loan files.

REDUCED SAMPLE FOR THIS STUDY
– Customers who have not had a loan from this company in the prior 90 days.
– States where: rollovers allowed; minimum loan duration is 7 days.
– Results in over 184,000 unique loans observations
### Characterizing the data

#### AVERAGE BORROWER
- 37 years old
- 70% male
- 20% own home
- 5 years at residence
- $22K annual net pay
- 73% w/ direct deposit

#### AVERAGE LOAN
- $284 loaned
- $51 interest (18%)
- 14 days to repay
- 468% Implied APR
Borrowers with Bi-Weekly Pay Periods: Loan disposition

Fraction of Borrowers

Loan Length

<table>
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<tr>
<th>Year</th>
<th>Repay</th>
<th>Renew</th>
<th>Default</th>
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<tr>
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<td>30%</td>
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<td>19</td>
<td>30%</td>
<td>40%</td>
<td>30%</td>
</tr>
</tbody>
</table>
Borrowers Paid Bi-weekly on Fridays

Days until next paycheck

Days to repay the loan

Friday Payday

Friday between paychecks

Similar borrowers with 13 day difference in loan duration
**Fraction who repay**

**Days until next paycheck**

**Borrowers Paid Bi-Weekly on Fridays**
Borrowers Paid Bi-Weekly on Fridays

Fraction who repay

Days until next paycheck

0.40
0.44
Borrowers Paid Bi-weekly on Thursdays

Thursday Payday

Thursday between paychecks

Days to repay the loan

Days until next paycheck
Borrower Paid Bi-weekly on Thursdays

Fraction who Repay vs Days until next paycheck

Days until next paycheck:

-14, -13, -12, -11, -10, -9, -8, -7, -6, -5, -4, -3, -2, -1
Borrower Paid Bi-weekly on Thursdays

Fraction who Repay

Days until next paycheck

0.42
0.44
Borrowers Paid Semi-Monthly

Days to repay the loan

Day of the month
Conclusions

SMALL EFFECT OF LONGER DURATIONS ON REPAYMENT
- Each week increases probability of repayment by 1-2 pct points

SHEDS SOME LIGHT ON THEORIES OF LOAN DEMAND
- Lack of response to longer durations consistent with many borrowers who have chronic budgeting problems, impatience, inattention, etc…

POLICY IMPLICATIONS
- Case for longer minimum durations only in annual interest-rate reduction
- This policy not appropriate to deal with debt spirals.
  - Policies focused on rollovers directly likely are more appropriate.
Joshua Sledge
Analyst, Innovation and Research Center for Financial Services Innovation (CFSI)
Payday Loan Alternatives

Joshua Sledge, Analyst, CFSI
February 14th, 2012
Center For Financial Security – Family Financial Security Webinar Series
Landscape of Payday Alternatives

- A number of payday loan alternatives have emerged in the marketplace
  - Financial Institution Small Dollar Loan Programs
  - Deposit Advance Products
  - Alternatives From Emerging Companies

- Many of these products have promising elements but structural challenges and/or consumer risks remain
Financial Institution Small Dollar Loans

• **What:**
  – Modified personal loans of under or near $1,000
  – Typically feature an installment repayment structure and low pricing (APR < 36%)
  – Often include link to savings, financial education

• **Who:**
  – Offered by a number of credit unions and community banks
  – Example: FDIC Small Dollar Loan Pilot
  – Example: NCUA program

**Promising Elements**

• Low pricing, installment structure
• Potential starting point for a bank, credit union relationship

**Challenges & Risks**

• Difficult to offer profitably – makes scalability a challenge
Deposit Advance Products

• **What:**
  - Loans offered as an add-on product to checking or prepaid card accounts
  - Allow customers to borrow against future direct deposit payments
  - Funds transferred to transaction account, repayment occurring via an automatic deduction

• **Who:**
  - iAdvance – discontinued in 2010 (UDAP)
  - Similar product currently offered by a number of large banks

**Promising Elements**
- Automated systems allow for more efficient loan operations
- Potential starting point for a bank, credit union relationship

**Challenges & Risks**
- Current products have relatively high prices and inflexible terms
- Concerns over the consumer impact of requiring automated repayment

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Alternatives From Emerging Companies

• **What:**
  - A variety of new loan products offered by emerging start-ups
  - Developing new underwriting systems for the underserved
  - Leveraging niche distribution strategies

• **Who:**
  - Retail: Progreso Financiero
  - Online: ZestCash, BillFloat
  - Employer: FlexWage, Symbius Financial, Emerge Financial Wellness

**Promising Elements**
- Many offer low pricing, flexible loan structures
- Potential for effectively underwriting the underserved

**Challenges & Risks**
- Scaling operations often challenging
- Limited opportunities for graduation, deeper relationships
Wrap-up

• Small dollar credit can play a positive role in consumers’ lives...
  – Can help households manage short-term cash shortages and emergencies
  – Can serve as a credit-building opportunity

• ...but it must be high quality to do so
  – Affordable and structured to support repayment
  – Marketed transparently and priced fairly
  – Ideally: linked with savings opportunities, tools for budgeting

• New alternatives offer potential, but more work to be done
  – Move toward accessible AND high-quality products
  – Regulation and policy challenge: Prevent abusive practices while encouraging promising strategies
February 2012

Ray Allen
Deputy Secretary
Wisconsin Department of Financial Institutions

PERSPECTIVES ON PAYDAY LENDING

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- Mid-’90s, semantics used to circumvent states’ credit laws
  - ‘Check cashing’ instead of PD loan store
  - ‘Deferred presentment’ definition
  - Fees not considered to be interest

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- Today, PD loans estimated at $27 billion
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  - 1.7 million loans
  - $735 million in lending
Federal Efforts to Regulate PD Loans
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- CFPB Director: ‘Now, the Bureau will be giving payday lenders much more attention.’
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  - PD loans redefined to mean a transaction for a term of 90 days or less
  - Permits interest after maturity of 2.75% per month
  - Requires repayment plan only once every 12 months
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  - 194,000 loans, compared to 1.2 million in 2010
  - $58 million in loans, compared to $483 million in 2010
Moving Ahead, What are the Challenges?
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- Typical PD borrower remains in debt for much of the year; many indebted for extended periods
- PD borrowers’ loans increase in size and frequency as they continue to borrow
- Significant number of borrowers default on loans, triggering more fees and jeopardizing bank accounts
March Webinar

Tuesday, March 13th
1pm - 2pm CDT / 2pm - 3pm EDT

Impact of Financial Counseling on Financial Security
Monica Martinez, New York City Office of Financial Empowerment

For more information on the 2012 CFS Webinar Series: http://cfs.wisc.edu