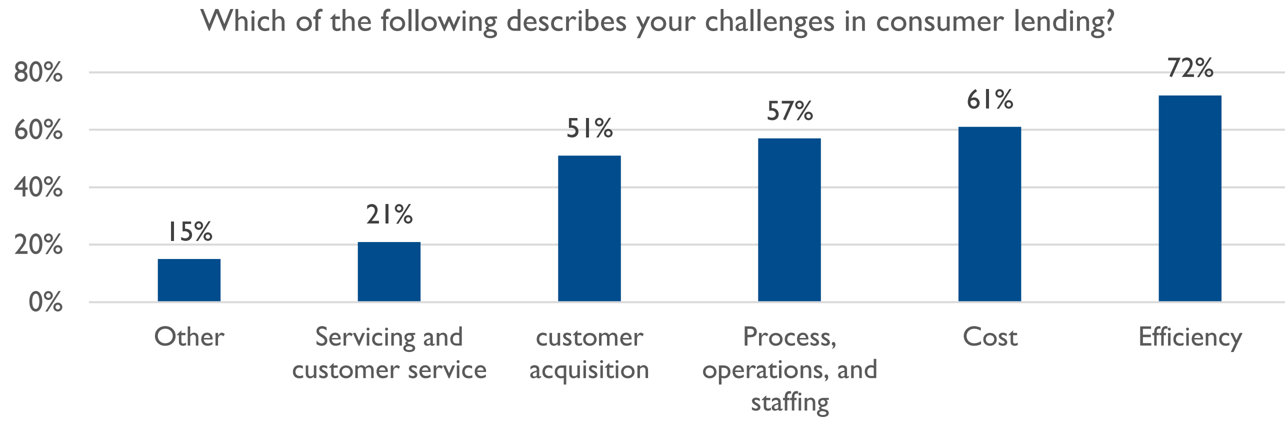
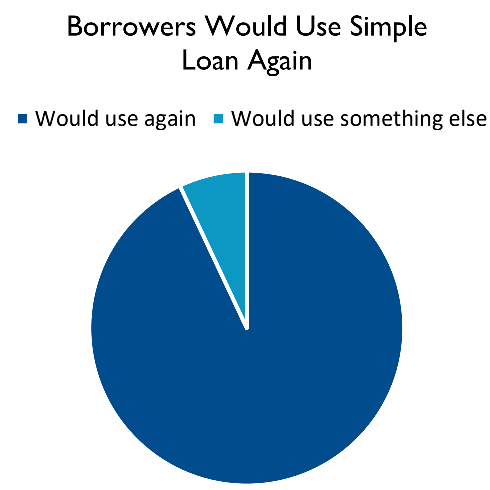
Mainstream Institutions Cannot Serve Nonprime

Banks

Banks do not generally offer short-term, small-dollar personal loans with APRs under 36% to nonprime consumers. In fact, banks struggle to provide unsecured consumer loans at all. Bank executives say that bank inefficiency, customer acquisition, and general costs are large obstacles in offering personal loans.[1]



In 2009, the Federal Deposit Insurance Corporation (FDIC) encouraged banks to provide small-dollar loans by initiating a two-year, small-dollar loan program. The catch was that loans could not exceed 36% APR. During the pilot program, participating banks realized that marketing, originating, and servicing these small-dollar loans were similar to the costs associated with larger loans. When these costs are annualized, however, the APRs appear astronomical. In the end, the FDIC concluded that "the interest and fees generated are not always sufficient to achieve robust short-term profitability."[2] In other words, banks were not able to earn a consistent profit under a 36 percent rate cap.

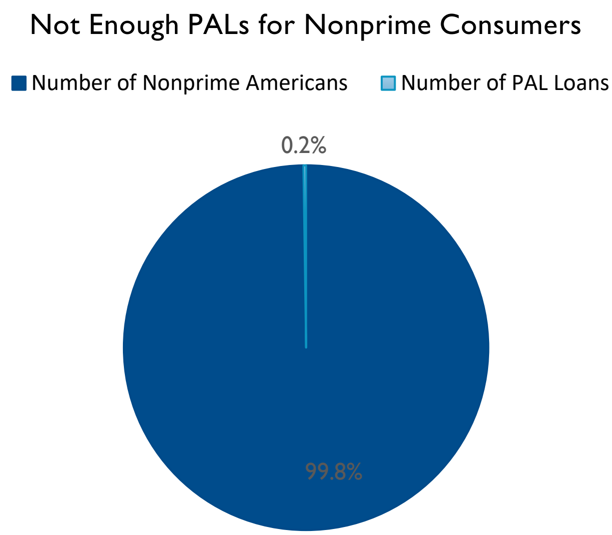


Ten years after the FDIC pilot program, U.S. Bank announced it would offer a new small-dollar loan product called U.S. Simple Loan, which carried APRs as high as 88%. Surveys show that 93% of consumers would use the loan product again and 98% understood the cost of the loan.[3]

Credit Unions

Consumer groups think that credit unions are able to offer short-term, small-dollar loans under 36% APR via their Payday Alternative Loan (PAL) program, which has interest capped at 28% plus an application fee. Adding that fee to allowable interest – which represents the total cost of credit – means that the average PAL has an APR nearing 43%, according to the Consumer Financial Protection Bureau (CFPB). The average 30-day PAL has an APR of 63%! Thus, even credit unions struggle to provide short-term, small-dollar loans under 36% APR.[4]

In 2018, credit unions were able to provide 211,000 total PALs, which encompass only two-tenths of one percent (0.2%) of the 100 million Americans who make up the non-prime consumer market. Moreover, the number of credit unions offering PALs declined by nearly 10% over the last five years, from 554 in 2014 to 502 in 2019. NCUA has announced an expansion to the program called PAL II which could reach more consumers, but this too has been criticized by consumer groups for the potential that some of these loans may carry APRs of 100%.[5]



After South Dakota imposed their rate caps, consumer groups claimed that state residents moved to credit unions,[6] but this is simply untrue. Jeff Olson, CEO of the Credit Union Association of the Dakotas, stated that credit unions did not see an increase in borrowers after the rate cap took effect. In fact, only one credit union in South Dakota offered PALs in 2018. On the other hand, pawn shops saw a 20-30% increase in transactions.[7] Pawn loans carry average APRs of 240%.

ENDNOTES

[1] "The State of Digital Lending," American Bankers Association, January 18, 2018. Available at: https://www.aba.com/-/media/archives/endorsed/abadigitallending-report.pdf?rev=5c8ea7c82dc34419a6570504d6d30a07.

[2] "A Template for Success: The FDIC's Small-Dollar Loan Pilot Program," FDIC. Available at: https://www.fdic.gov/bank/analytical/quarterly/2010-vol4-2/fdic-quarterly-vol4no2-smalldollar.pdf.

[3] This Week in Wall Street Reform, "Americans for Financial Reform, January 20, 2020. Available at: https://ourfinancialsecurity.org/wp-content/uploads/2014/12/FINAL-TWIWSR-Jan-19-Jan-25.pdf.

[4] "Payday, Vehicle Title, and Certain High-Cost Installment Loans," CFPB. Available at: https://files.consumerfinance.gov/f/documents/Rulemaking_Payday_Vehicle_Title_Certain_High-Cost_Installment_Loans.pdf.

[5] "Credit Union Regulator Expands High-Cost Loan Program Without Needed Safeguards, Say Consumer Groups," Center for Responsible Lending, September 19, 2019. Available at: https://www.responsiblelending.org/media/credit-union-regulator-expands-high-cost-loan-program-without-needed-safeguards-say-consumer.

[6] From CRL: "Data show that both credit unions' PAL loans and unsecured consumer loans made by credit unions continue to be available and have increased in volume since the enactment of the voter-affirmed rate cap."

[7] Bart Pfankuch, "Borrowers seek other sources after payday lenders," KELO, March 19, 2018. Available at: https://kelo.com/news/articles/2018/mar/19/study-borrowers-seeks-other-sources-after-payday-lenders/.