Report 8B

nonPrime101 WHITE PAPER

Can Storefront Payday Borrowers Qualify for a $500 Installment Loan Under CFPB Rules?

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Introduction

In Report #8 published on nonPrime101, this team asked the question: can an historical population of payday loan borrowers qualify for an installment loan under the standards laid out in CFPB's outline of possible small dollar regulations published in March, 2015? CFPB has now published a formal and detailed (1300+ pages) set of proposals for underwriting payday and "high cost" installment loans. We have seen in our Report #9 that only 25%-33% of current storefront single-payment loan borrowers would pass the CPFB's "ability to repay" screen, as applied to loans they actually received. This report answers the question: how would the same borrowers fare with a hypothetical "high cost" installment loan under the CFPB criteria?

Our source for a hypothetical loan was a group of existing, storefront small dollar installment lenders. We asked them what terms they would need to be profitable with a $500 loan payable in equal, amortizing payments over 2-6 months. Storefront single-payment loans are typically for $500 or less. The full model terms, all at 99% simple interest, are set forth in **Appendix Table 1.**

CAN AN HISTORICAL POPULATION OF PAYDAY LOAN BORROWERS QUALIFY FOR AN INSTALLMENT LOAN UNDER THE STANDARDS LAID OUT IN CFPB'S OUTLINE OF POSSIBLE SMALL DOLLAR REGULATIONS?

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Summary Conclusions

Looking first at consumers paid bi-weekly (roughly 70% of all payday consumers), nearly 70% could afford to repay the model loan over 12 paychecks. More than 62% could afford to repay the loan over 4 paychecks.

Monthly-pay consumers fare less well, with only 48% able to make the payments, largely because monthly payroll customers in the storefront payday population have lower average incomes.

For both groups, the "pass" rate is substantially higher than what we found for existing storefront payday loan relationships, suggesting that a path to alternative credit access might exist for the storefront payday customers who almost certainly will lose access to short term credit if the CFPB rule takes effect.

As we have noted in Report #8, however, there is a significant state law problem. While roughly 36 states allow some form of high rate single-payment loan lasting 2-4 weeks, only about a third of those states will allow a high rate multi-payment loan, even if it lasts only 8-24 weeks[2]. Thus, while the CFPB's rule might have the effect of driving consumers into more affordable loans in the abstract, there is a significant state law impediment to retaining non-prime consumer access to small dollar credit.

70

70% OF CONSUMERS PAID BI-WEEKLY COULD AFFORD TO REPAY THE MODEL LOAN OVER 12 PAYCHECKS.

62

62% OF CONSUMERS PAID BI-WEEKLY COULD AFFORD TO REPAY THE MODEL LOAN OVER 4 PAYCHECKS.

2. A complete inventory of state law limitations on installment loan terms can be found at http://www.nclc.org/issues/installment-loans.html

Data Sources and Methods

Our source for storefront payday loans and borrowers is described fully in nonPrime101 Report #7-B. For this study, we randomly selected 90,000 loans and borrowers from approximately 15.6 million storefront payday loans made in 2013. We appended to those records the debt service obligations of the borrowers at the relevant times, as reported in both a nationally recognized credit bureau and in Clarity records.

Of the original set of borrowers, Clarity production data contained income information from 2013 loan inquiries (often multiple inquiries) for nearly 85,000 borrowers. Because we had multiple income values for many consumers, we used a median value for the year 2013[3].

We then applied the CFPB's proposed methodology to compute residual income after payment of debt service obligations and used the income remaining to cover a new loan payment after paying basic living expenses (as defined by the CFPB proposal). CFPB defines basic living expenses as those necessary for the borrower's health, welfare and ability to produce income, including health and welfare expenses of dependents. We translated this into expenses for shelter, food, transportation, communication, medical care and dependent child care. Where the consumer reports included debt payments for shelter (a mortgage payment) or an auto loan, we used those values. In all other cases, we proxied expenses based on data from the Bureau of Labor Statistics (BLS) and the U.S. Census Bureau, both sources endorsed in CFPB's proposal. The BLS data is segmented based on income and age of the consumer, and we used those segmentations.

90K

nonPrime101 RANDOMLY SELECTED 90,000 LOANS AND BORROWERS FROM APPROXIMATELY 15.6 MILLION STOREFRONT PAYDAY LOANS MADE IN 2013

3. In Report #9, we used multiple income values from production data and from the master storefront dataset. The relationship of the various income values and their (relatively minor) effect on outcomes can be seen in Report #9.

BLS data is also based on a "consumer unit" of multiple income earners in a household. Payday borrower income reported in the Clarity system and in the lender records we used is individual income data (usually based on a single, current paystub). Accordingly, expense data was pro-rated based on the number of income earners in a "consumer unit" in the relevant segment in the BLS data[4]. Similarly, mortgage payment amounts reported to us by a national credit bureau were prorated based on the number of mortgage obligors, using the methodology provided by the reporting agency.

PAYDAY BORROWER INCOME REPORTED IN THE CLARITY SYSTEM AND IN THE LENDER RECORDS WE USED IS INDIVIDUAL INCOME DATA (USUALLY BASED ON A SINGLE, CURRENT PAYSTUB)

We first computed the count and percentage of borrowers who had negative residual income after paying pre-existing debts and basic living expenses. For those who had a positive residual income, we then computed the count and percentage whose residual income exceeded the required payment on the model loan in question. For monthly payroll consumers, we compared a hypothetical monthly loan payment to monthly residual income. For semi-monthly and bi-weekly payroll borrowers (whose new loan payments are due at the end of a less-than-monthly payroll period), we used a corresponding percentage of residual income (e.g., a semi-monthly payroll borrower has half of their monthly residual income available to make a model loan payment due at the end of the payroll cycle) and applied it to a hypothetical bi-weekly loan payment. This methodology does not take into account the "lumpiness" of some payments, such as rent, and therefore may overstate the number of consumers who can make a hypothetical loan payment, meet their other expenses, and have money left over. Accordingly, we provided information on the mean and median cash available after making the hypothetical loan payment.

4. We note that the hypothetical competing loan product modelled in this paper is usually underwritten using 100% of household income and 100% of household expenses. Because household income in this demographic is predominantly produced by multiple individuals, we do not think that using (for example) half of income and half of expenses for a two-earner household would significantly overstate the positive results in this study. Indeed, given the predominance of female borrowers in the storefront payday space, and the historical under compensation of female wage earners as compared to their male counterparts, there is an argument that our model may understate the "pass" rate for household applications for the model loan.

Results

The results are shown in **Appendix Table 1.** As explained in Report #9, monthly-payroll customers of storefront payday lenders tend to have lower incomes, and roughly half of them could afford our hypothetical loan. In contrast, depending on the duration of the loan, 62.2% - 69.8% of bi-weekly and semi-monthly payroll customers could afford the hypothetical loans under CFPB's ATR test.

69.8

62.2% - 69.8% OF BI-WEEKLY AND SEMI-MONTHLY PAYROLL CUSTOMERS COULD AFFORD THE HYPOTHETICAL LOANS UNDER CFPB'S ATR TEST

As noted above, CFPB adds further requirements dealing with "lumpiness" of expenses for bi-weekly payroll borrowers; in each payroll period the consumer must have enough residual income to make the loan payment and meet all living expenses, even if the expenses (like rent) are large monthly amounts. We do not have the data to model this requirement[5]. We note that prime consumers meet this requirement by having savings (or baseline liquidity) to deal with "lumpiness" and are not required to meet every expense purely out of income when it is due, but that is not allowed under CFPB rules.

Despite the foregoing caveat, it appears that the hypothetical loans could provide replacement access for more than half of the consumers who will be frozen out of the single-payment loan market under CFPB ATR requirements.

As noted above, however, there is a significant state law obstacle to this market solution. According to an exhaustive recent study, only 10 states allow a $500 six-month installment loan at the rates modelled here (99%)[6]. There are 36 states that currently allow some version of a single-payment loan at rates between 260% and 391% (or with no rate cap). Thus, unless state legislatures modulate their approach to small dollar credit in response to federal law requirements, roughly 37%[7] of our sampled borrowers will be denied affordable credit as a result of inconsistent approaches taken in state and federal law.

5. One way to meet this requirement would be to loan enough money to provide liquidity throughout the month, as well as meet the immediate purpose of the loan. It is unlikely that CFPB would allow such an approach.

6. http://www.nclc.org/issues/installment-loans.html See the table at page 5 and chart at page 8.

7. Roughly 70% who qualify for an installment loan minus 33% who "pass" CFPB requirements for a payday loan and presumably will continue to access that form of credit (if it is still offered).

Appendix Table 1

Can Storefront Payday Borrowers Qualify for a $500 Installment Loan under CFPB Rules?

BASED ON RESIDUAL INCOME COMPUTATION USING BLS PROXIES (USING MEDIAN INCOME OVER 1 YEAR AS MEASURE)						
TOTAL SAMPLE = 84,668	**Monthly Payment**		**Bi-Weekly Payment**			
	#1	#2	#3	#4	#5	#6
Total Count	25,321	25,321	45,647	45,647	45,647	45,647
Count of Borrowers with Negative Residual Income- Before Loan Payment	11,727	11,727	11,770	11,770	11,770	11,770
Count of Borrowers with Positive Residual Income- Before Loan Payment	13,593	13,593	33,877	33,877	33,877	33,877
Count of Borrowers with Negative Residual Income- After Loan Payment	12,954	13,110	17,254	15,489	14,713	13,791
Count of Borrowers with Positive Residual Income- After Loan Payment	12,366	12,211	28,393	30,158	30,934	31,856
Percentage of Loans Permitted after ATP Analysis is Complete	**48.8%**	**48.2%**	**62.2%**	**66.1%**	**67.8%**	**69.8%**
Mean Positive Residual Income*	$966	$967	$533	$543	$550	$555
Median Positive Residual Income*	$683	$684	$395	$406	$413	$419
	#1	**#2**	**#3**	**#4**	**#5**	**#6**
Loan Amount	$500	$500	$500	$500	$500	$500
APR	99%	99%	99%	99%	99%	99%
Payments	7	6	4	6	8	12
Payment Amount	$96.86	$108.98	$137.12	$94.78	$73.68	$52.68