Bank/Credit Union Entry into the Payday Loan Market Opportunities and Obstacles

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Issues in Analyzing PDL Profitability

- Difficult task- kudos to authors for tackling.
- How does it impact the public policy debate? Does this study support the new FDIC examiner guidance?
- Contentious -- adequate data is lacking for conclusive analysis. Can FDIC require better data from banks contracting with payday lenders?
- Allocation of parent's G&A – is this all "overhead"?
- Volume drives profitability, repeat use drives volume: difficult to analytically separate.
- African Americans, military – seem to be an important customer base – conflicting studies.

A Different Research Approach

- Funded by the Casey Foundation, the U-Mass study looks at the potential for competition from depository institutions to lower payday lending costs.
- Instead of asking, “Do payday lenders charge to much?” the study asks, “Can depository institutions offer the same product at lower cost?”
- Seeks common ground.

Bank/Credit Union Advantages

- Payday customers are already bank or credit union customers.
- Infrastructure already established.

  Advertising, payroll, G&A account for 70%-85% of payday lender costs.
- Credit risk is reduced through direct deposit and use of auto deduct for repayment.

The NC State Employees Credit Union: A Successful Model

- Open end loan offered at 12% APR, with repayment in full on next payday – yes, that's right 12%!
- Mandatory savings component has generated $6 million in deposits.
- Program runs at a 7.76% profit.
- 60 day delinquency rate-1.38% of outstanding balances.
- Suggests that banks could make their "hurdle rates" while staying below state usury limits, even after paying taxes…

How Not to Compete: Fee Based Overdraft Protection

- Lack of APR transparency hides true cost, inhibits ability of consumers to compare.
- Enormous fee income provides disincentive for banks to offer lower cost short term, small dollar credit products.
- Bernstein Call Report– customers are catching on and turning to payday lenders for their cheaper product!

The Right Way: Citibank Checking Plus

- Only ODP plan now offered by Citibank– fee based programs being phased out.
- LOC at 17% APR. $5 annual membership fee. Up to 60 months to repay.
- Citibank is experimenting with more flexible credit criteria. Applicants with lower credit scores can qualify for a $500 line of credit if they have been customers in good standing for six months.
- Most banks/credit unions already offer checking account linked LOCs. Just a matter of expanding availability.

Regulators Can Help

- OCC/OTS guidance needs clarification–interpreted as discouraging PDL alternative products “in the bank.”
- CRA credit for low cost programs.
- Clarification of capital standards and rules regarding repeat use.
- Public statements of support, as was done for bank/credit union entry into the remittance market.

Multi-Faceted Strategy is Needed

- Bank/Credit unions can provide lower cost product for part of the market.
- Regulatory standards needed.
- Finance companies, credit card advances also part of the mix – multi-line providers will be well-positioned.
- PDL/Bank alliances unlikely to win broader regulatory acceptance unless they change the underlying model.