

Consumer Measures Committee

Alternative Consumer Credit Market Working Group

Summary of

“Affordable Credit options for Vulnerable Consumers”

**Research conducted by Professor Jerry Buckland
September-October 2009**

In August 2009, Professor Jerry Buckland¹ was contracted by CMC to study the issue of affordable credit options for vulnerable consumers. The study focused on identifying alternatives to various types of fringe credit products such as payday loans, sub-prime credit cards and pawn loans.

This document provides a brief summary of Professor Buckland’s report, then provides a condensed version of his discussion about the findings, and finally reproduces the full text of the conclusions of his research. A list of all the programs and services studied is appended.

The research was conducted, and this summary is provided, for information.

1. Brief Summary of Research

The report provides an inventory of approaches taken in Canada, Australia, Belgium, Germany, France, the United Kingdom and the United States to:

- provide lower-cost alternatives to high-cost small short-term loans (such as payday loans) for consumers, and
- encourage traditional financial institutions to offer such alternative services.

The research for the report was carried out from August to October 2009. Professor Buckland conducted a literature review and made contacts with various stakeholders directly involved in various programs and services described.

Professor Buckland found a significant number of affordable credit services for vulnerable consumers in the countries examined. The numbers and sizes of the services or programs were most significant in the United States, Australia and the United Kingdom; Belgium, France and Québec had a middle range of programs and services; and Canada outside of Québec, and Germany had few identified services.

¹ Jerry Buckland, Ph.D., is Associate Professor of International Development Studies at Menno Simons College, University of Winnipeg. Professor Buckland’s interests and teaching areas include micro-financial services and poverty, rural development and food security, non-governmental organizations and community development.

Professor Buckland defines the vulnerable consumer as “a citizen relying to some extent on the market but who lacks some type of economic, social or political power, directly or indirectly, in relationship to the credit supplier.” He found that there appear to be two types of consumer loans fitting the general category of affordable credit for vulnerable consumers:

- ***Social consumer micro-loan***– Such loans are often provided by programs that have economic and social objectives, and may offer either
 - (a) larger loans (\$1,00-\$4,000), offered in Australia, Belgium and France; or
 - (b) smaller loans (\$500-\$1,000), offered in Québec and the UK.

These loans are provided on generous terms (low interest rate, 0-10% APR, or annual percentage rate; and long repayment period, 1-3 years), offered in collaboration by a Financial Institution (FI) and a nonprofit and/or government agency. These services do not cover their costs and so require additional resources from elsewhere, often from the state and nonprofit organizations.

- the ***consumer micro-loan***, closer in character to a payday loan, is generally offered by an FI on its own, with terms that are close to those found with other mainstream bank credit products (e.g., credit cards and lines), including interest rates between 11% and 36% APR, sizes ranging from \$50 to over \$5,000, but most ranging from \$100 to \$1,000. In some cases these loans mimic the payday loan 2-week period and in other cases having longer repayment terms, say 3 to 12 months. These loans can be offered in ways that allow the FI to cover its costs or, for the business case to be made, through attracting new clients into the bank who will eventually use more profitable bank services, i.e., the loss leader idea. These loans are offered by a variety of banks and credit unions in the US and by the National Australian Bank (NAB) through its Small Loan Pilot program in Australia.

2. *Condensation of the Report’s Discussion.*

Overall, data on both categories of loans demonstrate a diversity of products that are considerably more attractive than payday loans and similar credit offerings: for services offered in partnership with nonprofits (examples of which were found in Australia, Québec, Belgium and France), interest rates are single-digit. For most services offered solely by an FI, the interest rate is higher, ranging from 11% to 36% APR (though up to 120% in the case of one bank).

Loan volumes – in terms of number of loans and amounts loaned – range considerably across the programs examined. Among the social consumer micro-loan programs, loan volumes vary from smaller programs like that of Desjardins, which since its inception has originated a total of \$2 million in 3,456 loans, and approximately \$670,000 in just over 1,000 loans in the past year. The Australian programs ranged from the ANZ Bank’s Progress Loans of around 200 loans valued at around \$320,000 (\$A300,000) per year to the no-interest loan service (NILS) program of 5,500 loans valued at \$4.3 (\$A4 million) per year. A Belgian program’s annual volume was approximately 150 loans amounting to \$714,000 (€450,000) per year.

Consumer micro-loan volumes also range considerably. The National Australian Bank's (NAB) Small Loan Pilot Program provided 1,312 loans annually, amounting to \$4.7 million (\$A4.4 million). The U.S. programs range from modest levels of 37 loans valued at \$22,500 per year (\$US20,700), to larger volumes of 44,101 loans valued at \$14.8 (\$US13.6) million per year. These volumes are likely lower than some of the volumes for banks participating in the Federal Deposit Insurance Corporation's (FDIC) Small-Dollar Loans Pilot Program, but those data were not available.

The repayment periods for the different loan schemes vary from a 'payday loan' term of two weeks, up to four years. Typically, social consumer loans have longer repayment periods, usually between one to three years. The consumer loans have shorter terms: two weeks to 24 months, with most repayment terms ranging from three months to one year. In some cases repayment is one-time, in other cases it involves several payments.

Many of the organizations offering these loan services (in both categories) also offer counseling and education on budgeting and personal finances. In some cases this component is required (as with the Desjardins program, Crédal Plus' *Crédit Social Accompagné*, Crédit Agricole's *Crédit Solidaire*, and ANZ Bank's Progress Loans). Sixteen of the 31 banks involved in the FDIC pilot require some type of financial education. In other cases, the education component is a requirement only for certain participants (such as consumers with particularly low credit ratings). In other cases the education component is optional, as with Wells Fargo's Direct Deposit Advance..

Information on program financing was difficult to obtain, in part due to the proprietary concerns of some of the FIs involved. Some data were available regarding loan losses; there were some data available on overall costs as well, but usually only qualitative statements were available on the breakdown of costs. These statements generally noted that the loan schemes have higher costs than mainstream loan schemes because they require more staff time to process.

Default or delinquency rates and charge-off or loan-loss rates were generally kept to levels acceptable to the FIs. In some cases the default rates were higher than what the FIs experienced in their overall consumer loan portfolios, while loan-loss rates were similar to those of their general consumer loan pools.

The research identified different financing models used for the credit services. It is generally understood that social consumer loans cannot cover costs solely with revenue from service fees. In these cases the FI, government and/or nonprofit resources are often involved. With the consumer loans, the goal of self-financing is more common, but it is not clear how many of the FIs have been able to achieve the goal. Various source materials differed as to the capacity of some programs to finance themselves.

In the FDIC pilot, some of the banks have been able to achieve self-financing, or even generate a profit on their loan service; those banks have unique locales that provide access to a large number of new customers who are anxious to use their services. However, for most of the banks participating in the FDIC pilot, self-financing is not the goal; the small loans are seen as a loss leader, a way to bring in new clients who will eventually use more lucrative bank services. In contrast, there is evidence that some credit union programs have been able to cover program costs

with fee revenue. Notably, all FIs participating in the APPLE program reported positive net income.

Without more details from both programs it is impossible to precisely identify the reasons for the differences between the two programs. However, there are important differences between the participating FIs:²

- Size: The FIs involved in the APPLE pilot are smaller than the banks involved in the FDIC pilot. The APPLE FIs range from \$US2 to \$US285 million in assets. Banks participating in the FDIC pilot range from \$US26 million to \$US10 billion in assets.
- Loan terms: Within the APPLE pilot the loan terms range from 1 month to 18 months with the average being 6 months. The FIs involved in the FDIC pilot have loan terms averaging 12 months for small dollar loans and 16 months for larger loans.
- Borrowing costs: interest rates slightly higher for APPLE FIs (16%) compared with FDIC pilot FIs, and two-thirds of APPLE FIs had additional charges, as compared with one-half of the FDI pilot FIs.
- Locations: FDIC results found that few FIs operating in locales with higher proportions of low-income and immigrant Americans had profitable programs. By definition, the APPLE FIs, which are community-development credit unions, are more likely than banks to be working in these types of locations.

For both categories of loans, where data are available, the majority of the clients were often reported as female, and as young. However, such should be regarded with some caution, given they are based on programs that are limited in scope in terms of number of clients.

3. *Conclusions of the Research (full text of Professor Buckland's discussion)*

There is a surprising number and diversity of affordable loans schemes for vulnerable people in the seven countries studied. Two principal types of loan services were identified: social and regular consumer micro-loans. The research identified the largest number of services and programs in the US, followed by Australia and the UK. Belgium, France and Québec had a moderate number of programs, and Canada (outside of Québec) and Germany had few identified services.

The regular consumer micro-loan is often offered solely (or with limited assistance from a community organization) by the FI. The social consumer micro-loan is often a team effort involving FIs, nonprofits, and government. With the social loan, there is a common division of labour between the FI and the community organization. Financial institutions partner with nonprofits to develop products that are useful to non-typical clientele, they generally provide the service, and they sometimes support operating and capital costs. Community organizations act as a 'bridge' linking communities with FIs, provide financial education, and support clients through the loan process (including repayment). Government support plays a role in many of these services through loan capital or supporting operating costs.

² In this discussion, Professor Buckland reminds us that the data is limited, and should therefore be used cautiously.

The loans are generally directed at low-income households and/or people who rely on payday loans. Data are limited but in the cases where the data are available, women and young and middle aged people (between 18 and 54 years old) represent the majority of the borrowers. This gender division was clearest for the social consumer micro-loan programs. The age division was found in all types of loans for which data were available.

Research and development (R&D) of new products for non-typical clientele emerges as an important issue. Many of these projects are ‘pilots’ or small-scale projects with the intention to be expanded once a proven model is established. The projects involve new products which are, at best, marginally profitable on their own. Thus FIs want to carefully design and test the product before they are replicated. The services in the US and Australia seem to be the furthest along in the R&D process and so they would be the most helpful for anyone interested in setting up alternatives elsewhere.

Loan volumes range considerably across the sample. Some programs are offered through other institutions (UK and French funds) and some programs are offered through one or several outlets or branches so that it is difficult to make comparisons with commercial loan programs. In terms of the social consumer micro-loan programs, loan volumes ranged from 200 to 5,500 loans per year and valued at \$320,000 to \$4.3 million per year. Consumer micro-loan volumes also range in size from 37 to 44,101 loans per year valued from \$22,500 to \$14.8 million. By way of comparison, loan volume among Manitoba payday lender outlets ranges from \$700,000 to \$3 million per year, averaging \$1.5 million per year. It is estimated the industry lends \$2.2 billion each year. This suggests that one of the larger social or consumer micro-loan schemes is similar in size, based on value of loan volume, to one Manitoba payday loan outlet. The entire FDIC Small-Dollar Loan Pilot, with 31 banks, originated 16,000 loans for a value of \$20.1 (\$US18.5) million. This is just under 10% the value of the Canadian payday loan volume.

An important aspect of small and affordable loans is their financial viability. Are small loan programs able to generate sufficient revenue to compensate for their costs? Loan losses are reported to be at a reasonable level but some organizations reported that operating costs were higher than for more automated loan schemes. This is due to the staff-intensive nature of the programs.

Given data limitations, what can be said about program financing? One conclusion is that the social consumer micro-loans are not self-sufficient. They provide generous terms and involve in-depth staff support (e.g., financial education) such that they are not designed to, and do not achieve financial self-sufficiency. In terms of the more economically focused consumer micro-loans, the evidence presented here was limited and somewhat mixed. The best data available were the qualitative and general results from the FDIC Small-Dollar Loan Pilot Program, and from a study of the APPLE Program. The former study argued that only a few banks were able to cover program costs and generate a profit while the latter study found that all six participating credit unions had self-supporting programs. In the previous section it was argued that these results are not necessarily in conflict. Factors such as the size of FI (the relatively smaller community development credit unions were more successful), loan terms (slightly higher fees and shorter repayment terms were found among FIs achieving self-sufficiency), and the location of the branch (both FDIC and APPLE projects in lower-income neighborhoods appear to have

been more successful) may explain the different results. Without more detailed data these results should be used cautiously.

Most of the loan schemes offer, or require clients to engage in, some financial education. In some cases low default rates are attributed to the financial education and to the general support clients receive from staff through the application, receipt and repayment process. Considering the high levels of consumer debt in Canada the financial literacy component may be appropriate. However, it will depend on the client. It is not appropriate to assume that low-income clients lack financial knowledge. They may be very knowledgeable about their financial reality.³

Since several types of organizations are involved in these programs, clarifying each one's role is important. Commonly the FI is the chief developer and provider of a new financial service, and the nonprofit serves as co-developer and link to vulnerable consumers and communities. The government roles seem to vary. Providing clear public policy, funding (capital and operations), and supporting research are common roles identified in this research.

A variety of types of FIs are involved in these loan schemes. In Australia two banks have played the central role. Banks have been important elsewhere, including in the US FDIC Small-Dollar Loan Pilot Project. But, in many programs in the US, and programs in France, Belgium and Québec the role of what Anderloni (*et al.* 2008) termed the 'commercial—social-mission' FI sector (cooperative banks, credit unions, etc.) is critical. These FIs have explicit financial and social objectives for their operations. Presumably it is this combination of objectives that has compelled coop banks and credit unions in Europe, the US and Québec to pursue affordable loans for vulnerable consumers.

This report has not provided insight into the significant role of nonprofits in the schemes they are involved. This is partly because the focus of this research project was to scan and describe key features of relevant loan programs in the seven countries. This report thus lacks a more textured presentation of the loan schemes. A critical aspect of the texture is how the service relates to its clients, and for many programs, nonprofits play a bridging role here.

Governments have been active in a variety of ways in these programs. Governments have funded loan capital and operations and they have supported research into payday loan alternatives. The French (Social Cohesion Fund) and UK (Financial Inclusion, Growth, and Social Funds) governments have established funds for loan capital or guarantees to participating FIs. There are no doubt challenges for this approach but since it is new it is hard to determine how effective it is.

Regional and local governments have supported operating costs of loan services in Australia, Belgium and France. Government has also been active in research, most notably in the US through the FDIC Small-Dollar Loan Pilot Project, but it has also helped fund research for other projects (e.g., Winnipeg's Community Financial Services Centre). Along with research

³ Forthcoming research by Professor Buckland is expected to examine the extent to which low-income consumers have levels of financial literacy that should not necessarily be described as low. Rather, low-income consumers often are forced to develop a level of financial literacy that allows them to cope with their personal and structural constraints.

done by US credit unions (REAL and APPLE), the FDIC project is one of the best sources of data on payday loan alternative services. Of course the FDIC chairperson, Sheila Bair, brought with her to the position an expertise in bank action regarding payday loans in the US. This may partly explain the FDIC's leadership regarding payday lending alternatives.

Overarching policy is an important issue that has not been addressed in this study. However, in investigating affordable credit options, the UK financial inclusion strategy stood out among the seven countries. The strategy has several components including encouraging banks to expand the number of bank accounts they provide, the expansion of credit union system and its ability to provide credit, and the expansion of financial education. Through the Office of Fair Trading the government is also examining issues of consumer protection related to financial services. It's too early to assess the success of the strategy, but it holds many elements that could make it successful. One weakness is that there is an appearance of a top-down approach. But this may not be the case in reality. Once the community-banking partnerships develop, the fruits of these efforts may appear.

The Desjardins Federation program demonstrates a substantial interest in Québec for this type of project. There are few loan schemes in Canada outside Québec. There is an overdraft program at Pigeon Park Savings (Vancouver) and there was a small loan scheme through the Community Financial Service Centre (Winnipeg), but it is now on hold. The situation in Québec may be partly explained by the more federated nature of the *caisse populaire* system, as compared with the more competitive nature of credit unions in other Canadian provinces. The stronger tradition in the social-economy in Québec may be another factor at work. In Québec, payday loans have been virtually outlawed through the provincial usury ceiling.

It is unclear why there are not more loan services and programs in Canada outside Québec. Except for Québec, Canada has witnessed a rapid growth of payday lending, and there is a well-developed credit union sector in many of the provinces. One reason noted was that the absence of regulation of payday lending acted as an obstacle for FIs to get involved in small loans. This is changing now, as provinces unveil regulations. Another potential challenge for FIs interested in small loans is that regulations will vary between provinces. This might make national programming and inter-FI collaboration, so important in the US, more difficult. The example in the US is that associations (CUNA and National Federation of Community Development Credit Unions) played an important role in bringing individual credit unions together to engage in R&D on the affordable credit service. By working together they were able to find resources to engage in effective research and to develop products that are now commercially available. A final factor that might be at work is that credit unions have opted to invest program resources into other services such as asset building and financial literacy instead of consumer micro-loans.

4. *List of programs and services examined*

Australia

No Interest Loans Scheme (NILS)
Progress Loans
Small Loans Pilot
Service: Step UP Loans

Belgium

Crédit Social Accompagné ("Guided Social Loan")
Overdraft protection for Social Bank Account
Pawn loan

Canada

Fonds d'entraide Desjardin/Mutual Assistance Fund
Micro-loan (North End Winnipeg)(Implemented but now on hold)
My Best Interest (Plan that was not implemented)
Overdraft protection (Pigeon Park Savings)

France

Loan guarantee from Fonds de cohésion sociale
Crédit solidaire
Crédit Mutuel Mid-Pyrénées with Secours Catholique
Prêt sur gage/Pawn loan
Social micro-credit

Germany

Service: Pawn loan

United Kingdom

Financial Inclusion Strategy
Community Banking Partnership
Financial Inclusion Fund
Eligible Loans Deduction Scheme
Growth Fund
Budget and Crisis Loans from Social Fund

United States

REAL Solutions: Payday Loan Alternatives
Retail Financial Services Initiative (RFSI)
Small-Dollar Loan Pilot Program
The Alternatives to Payday Lending Program (APPLE)
Collateral loans
Direct Deposit Advance line of credit
Payday Alternative Loan (PAL) - North Side
Payday Alternative Loan (PAL) – Veridian
Salary Advance Loan (SALO)
StretchPay: A Credit Union Salary Advance Alternative
The Worker's Loan Program