Common Cents Financial Initiative Learning Brief

Helping consumers out of the payday lending debt trap

October 2008

Introduction

In May 2007, Mountain Association for Community Economic Development (MACED) launched the Common Cents Financial Initiative, a pilot program that offers an alternative to payday loans. Offered through a network of participating employers using an online application, the program provides a 10-month term loan, a savings account and financial education.

There are 106 million Americans who do not have an existing relationship with a financial institution, or are underserved by a financial institution.[1] People that don't have a relationship with a financial institution have difficulty cashing paychecks and paying bills and are less likely to have savings. Until recently, far too little attention was paid to this unbanked and underbanked population. The pilot is designed to provide a potentially scalable and convenient loan product that links unbanked and underbanked consumers to traditional financial services.

The Problem

Low- to moderate-income workers are often unable to access credit or short term debt to cover unexpected expenses or bridge gaps between paychecks. People that are short on cash can no longer turn to employers, friends or family for help as they did in the past. Desperate financial situations require that individuals turn to predatory payday lenders in moments of crisis. Payday lending outlets are ubiquitous because they fill a need.

Payday loans, or paycheck advances, are small, unsecured short-term loans, intended to bridge the borrower's cash flow gap between paydays. Financially distressed individuals often turn to payday lenders as a last resort, pay annual interest rates in the range of 400 percent and find themselves in a cycle of rollovers, often resulting in fees that can double the original loan amount within three months.

Rural Appalachia is filled with predatory lenders who provide expensive financial services to low-income people in need, stripping hundreds of millions of dollars a year from families. Payday lending is one of the most abusive predatory lending practices in rural America today. Americans lose approximately $4.2 billion a year to this practice.[2] The Carsey Institute's 2006 report "Subprime and Predatory Lending in America" finds that lack of access to financial alternatives in rural communities leaves consumers susceptible to predatory financial institutions and products, diminishing their ability to save and build wealth.[3]

In July 2008, the Center for Financial Services Innovation released a report entitled "A Fundamental Need: Small-Dollar, Short-Term Credit." That report describes the situation that led to the rise of payday lending in America and details what is being done to provide consumers with an alternative form of short-term credit. Visit www.cfsinnovation.com to learn more.

The Brookings Institution's study "The High Price of Being Poor in Kentucky" found that the market for these high-priced services is vast and rapidly growing.[4] Between 1999 and 2006, the number of payday lender retail locations grew by 121 percent in Kentucky. New establishments now open in Kentucky at the rate of one every four days, collecting an estimated $145 million in fees from their mostly lower- and moderate-income customer base. MACED recently conducted research that found more than 170 active payday loan outlets in our 51-county primary service area of Appalachian Kentucky.

Common Cents Financial Initiative

In 2006, MACED recognized the growing number of payday lenders appearing throughout Appalachian Kentucky. Several business owners reported their employees getting into serious financial trouble with payday lenders. One business owner reported writing off several thousand dollars in payroll advance loans to his employees after deciding it was not worth the effort to collect. This information prompted MACED to survey 20 local businesses about their frequency of payroll advances and their sense of the economic challenges facing their employees. Fifty percent of the businesses surveyed granted requests for payroll advances in the last 12 months.

Later in 2006, MACED conducted two focus groups with current and potential payday loan users to better understand their use of these products. The focus groups confirmed that the price of short-term credit was not the major consideration for borrowers. Ease of use and access were important to them. Payday lenders in rural Appalachia, like much of rural America, have a storefront presence in most small communities. They are attractive because they provide extremely fast and easy access to credit, albeit at a high cost.

MACED launched the Common Cents Financial Initiative (CCFI) and Save It! Loan product in May 2007 to provide financial services to the underbanked and help low- to moderate-income workers break out of the cycle of debt, change financial behavior and build wealth through savings.

MACED took the following factors into consideration when designing the initiative.

- **Convenience —** The product must be easy to use so consumers consider it an alternative to predatory payday lenders.
- **Affordability —** The product must be significantly less expensive than payday loans.
- **Potential behavior-changing elements —** The product should link the borrower to meaningful savings and educational opportunities, reducing the need for emergency cash.
- **Links to other financial services —** The program should link the borrower to other financial services including savings and checking accounts and other forms of credit.
- **Income generating —** The program must have the potential to generate funds to cover a meaningful percentage of its cost.

Program Elements

Through a delivery system that combines partnerships with employers and an online application, CCFI offers several major components including the Save It! Loan, an accumulating savings account and financial education.

Delivery system: The Save It! Loan is a web-based program offered through participating employers as a benefit to their employees. The website (www.saveitloan.com) provides convenience as borrowers apply online. Employers facilitate participation with direct deposit repayment and provide on-site support through an employer-designated program coordinator. Payroll debit repayment transactions help borrowers stay current with payments and reduce the risk associated with providing the loans. Borrowers have the option of having the loan disbursed directly to their bank account or to a stored value card which can be reloaded and comes with tips to use the card as a budgeting tool.

Employee eligibility: Employees must be employed for six months at the partnering employer to be eligible for a loan. We do not check credit to establish terms or repayment. Employers do confirm employment through the website after their employee has applied. Loan amounts are tied to salary levels.

Loan product: The Save It! Loan is a 10-month term loan at 18 percent interest. Loan amounts range from $300 to $500 based on salary and are repaid through payroll deductions. In the pilot phase, the loans have been made and serviced by the Appalachian Federal Credit

A Sample Save It! Loan

The original loan amount is **$325**.

An additional 50% of the loan amount is put into a savings account for a total amount saved of **$162.50**.

The loan will be paid back once a month for **10 months** at **18%** interest.

The borrower pays back **$35.24** per month for the **principal and interest**.

The borrower pays back **$16.25** per month for the **savings contribution**.

The total payment is **$51.49** per month.

Union through loan applications generated from the website. Currently borrowers can only have one loan out at a time.

Savings component: The savings component is a unique feature of the Save It! Loan. By taking out a loan, the borrower automatically becomes a member of the Appalachian Federal Credit Union. An additional 50 percent of the principle amount borrowed is deposited in a savings account at the credit union and repaid by the borrower over the term of the loan. The savings account is accessible to the borrower when the loan is paid off. The borrower has full credit union membership privileges.

Financial education: Free financial education is provided to all employees of participating employers, not just borrowers. With employer cooperation, we distribute printed materials on key topics such as budgeting and debt management. In partnership with BALANCE, a financial fitness program, we offer phone-based financial counseling, and provide additional educational tools and resources on the Save It! Loan website.

Documenting Lessons Learned

The CCFI pilot design accommodates learning and evaluation that will help us better understand the impact of the Save It! Loan product on borrowers and inform ways to grow the effort. Multiple data sources provide information on:

- borrowers and their use of various financial services;
- employers and their perspectives on an employer-based loan product; and
- key players involved in product design and loan processing who can speak to the organizational and financial viability of this initiative.

We use several methods to evaluate efficiency, effectiveness and financial viability. We measure efficiency by tracking process times for each step of the process. Demographic data allow us to assess our success in reaching our target population of low- to moderate-income workers. Pre- and post-surveys track banking behaviors and allow us to document any changes among the general population of employees over the course of the year when we are providing financial education and counseling opportunities. Loan application data and post-loan surveys provide information on changes in banking and saving behavior among borrowers. In addition, customer satisfaction questions on post-loan surveys and in interviews with employers and borrowers provide qualitative measures of the Save It! Loan experience.

By the Numbers *(As of 10/1/2008)*

Participating businesses	10
Employees at participating businesses	1357
Loans made	212
Applications received	257
Average income of applicants	$17,533
Loans paid off	84
Second loans made	48
Total capital borrowed (including pre-funded savings accounts)	$99,000
Loans written off	24
Loans made on stored value cards	65
Amount of new savings generated	$33,000

The majority of denied applications are due to applicants not being employed for at least six months and garnishments resulting in an income less than the required minimum of $12,000.

Initial Learning

While the pilot is only a year and a half old, we are learning a great deal as we go. Some initial highlights include the following.

- The majority of employers contacted for participation understand their employees' need for such a product. While sensitive to the amount of time it takes to administer the program, participating employers view the product as a workplace benefit. Employer coordinators report consistently positive feedback about the program from their employees and the company's management.
- Access to the internet is not a deterrent to most borrowers. Workplace computers, assistance from employer coordinators and public computers have all been used to submit applications. Employees need email addresses to complete the loan application, but employers are willing to help employees set up a free email account.
- The application and loan management process require at least two engagements with the website from the borrower. Because of this, application-to-loan-close times have varied from one day to 14 days with an average of four. We aim for three days to process loans.
- Although the number of people in the United States saving regularly has dropped alarmingly over the last twenty years, many Save It! Loan borrowers are now doing so

The program's design helps the borrower develop positive behavior changes, like developing a savings nest egg.

enthusiastically. As one customer reported, "The amount withheld from my paycheck is nominal, hardly missed and therefore easily saved. I am upping the amount withheld and am going to continue to save." Information from post-loan surveys reflect that 70 percent of respondents reported they intended to keep and continue their payroll deduction into their Save It! Loan savings account.

Looking Ahead

Consumer demand for the Save It! Loan product is high. The success of the pilot in meeting demand and offering innovative convenience and education sets the stage for MACED to take CCFI to scale.

Over the next two years, MACED will expand the Common Cents Financial Initiative and work to improve the pilot model so we can serve a greater number of consumers. During this period, we seek to add 30 employers and 10,000 employees. We aim to make 1,000 loans at an average of $350 each, generate $175,000 in new savings among low- to moderate-income workers and deliver basic financial education to 10,000 consumers.

In order to reach that goal, we will engage in the following activities.

1. **Increase the number of financial institutions delivering the product.** During the pilot phase, we worked with the Appalachian Federal Credit Union. AFCU has predicted it will reach its threshold for making and servicing loans without adding additional staff by February 2009. Therefore, MACED currently plans to add additional financial institutions to the program in order to serve more customers in the next stage.

2. **Identify and recruit additional employers.** The primary recruitment strategies for the pilot phase have included contacting existing MACED business loan clients and seeking referrals to businesses from regional community development financial institutions. We are seeking to add county governments and large nonprofit organizations, as they tend to be large employers in rural Appalachia.

3. **Simplify and streamline program systems.** Making the Save It! Loan product competitive with payday loans is key to the successful implementation of this effort. We will make a series of significant changes to the loan process to keep the product as convenient and efficient as possible.

4. **Revise pilot model to achieve sustainability.** Financial sustainability will play a crucial role in CCFI's long-term ability to increase the financial security of lower-income consumers at a greater scale. Learning how to increase the financial viability of the initiative, while still offering a low-cost loan product, is a crucial challenge. We will revise our pricing structure and strive to lower costs to address this challenge.

Conclusion

The Common Cents Financial Initiative represents a new approach to helping people break the cycle of poverty by providing an alternative to usurious payday lending practices. The need to bridge the gap between rural underbanked consumers and the financial services industry, in Central Appalachia and across America, cannot be overstated.

For more information about CCFI or MACED, visit www.maced.org or call 859-986-2373.

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Endnotes

1. *The CFSI Underbanked Consumer Study Fact Sheet*, http://www.cfsinnovation.com/research-paper-detail.php?article_id=330366, Center for Financial Services Innovation, June 2008.

2. *Financial Quicksand*, http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf, Center for Responsible Lending, November 2006.

3. *Subprime and Predatory Lending in Rural America*, http://www.carseyinstitute.unh.edu/publications/PB_predatorylending.pdf, Carsey Institute, Fall 2006.

4. *The High Price of Being Poor in Kentucky*, http://www.brookings.edu/reports/2007/06metropolitanpolicy_fellowes.aspx, The Brookings Institution, June 2007.

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MACED works to improve the quality of life in Kentucky and Central Appalachia by creating economic opportunity, strengthening democracy and supporting the sustainable use of natural resources. We are a multi-strategy community economic development organization committed to equipping entrepreneurs, communities and change agents with the tools they need to build stronger economies that work for low-income people and places in need.