High Cost Consumer Credit:
What it is, how it works,
and its consequences

Tom Feltner
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Informing communities about the financial services policy issues that impact them most

Documenting patterns of discrimination and helping local organizations and media understand the problem

Giving communities the tools to make better, safer financial decisions
Woodstock Institute
Problem: individual and community effects

Individual Effects

Community Effects
Refinancing or “rollovers” occur when borrowers can only make interest payments

<table>
<thead>
<tr>
<th>Rollover</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 weeks</td>
<td>$46.50</td>
</tr>
<tr>
<td>4 weeks</td>
<td>$93.00</td>
</tr>
<tr>
<td>6 weeks</td>
<td>$139.50</td>
</tr>
<tr>
<td>8 weeks</td>
<td>$186.00</td>
</tr>
<tr>
<td>10 weeks</td>
<td>$232.50</td>
</tr>
</tbody>
</table>

High Cost Consumer Credit
Community: what communities are impacted?

Distribution and summary of payday loan defaults in 2005-2006

- 72% of defaults were female borrowers
- 70% of defaults were in LMI communities
- 90% of defaults were in minority communities

High Cost Consumer Credit

Individual: Title loans are difficult to repay in full

Nearly all loans contain balloon payments

- Balloon Payment (93%)
- Amortizing (7%)

Rollovers are common

- New Loans (77%)
- Rollovers (23%)

High Cost Consumer Credit
Community: What communities are impacted?

Distribution and summary of title loan defaults in 2005

- 56% of defaults were male borrowers
- 54% of defaults were in LMI communities
- 64% of defaults were in minority communities

High Cost Consumer Credit

Problem: Why do business with a predatory lender?

Predatory lenders market their products based on basic fears of financial transactions

Does it take too long?
Is it an intrusive process?
What if I have bad credit?
What if I have no credit?
What if I don’t have any collateral?

Source: Payday Lending Under the Illinois Payday Loan Reform Act. 2005 Woodstock Institute
## High Cost Consumer Credit

Solution: Identify barriers to credit alternatives

<table>
<thead>
<tr>
<th>Product</th>
<th>Availability</th>
<th>Cost</th>
<th>Constraints</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payday Loan</td>
<td>Now</td>
<td>High</td>
<td>Any Checking Account</td>
</tr>
<tr>
<td>Credit Card</td>
<td>Application Processing</td>
<td>Moderate</td>
<td>Credit Rating</td>
</tr>
<tr>
<td>Overdraft</td>
<td>Now</td>
<td>High</td>
<td>No Repayment Mechanism</td>
</tr>
<tr>
<td>Credit Union</td>
<td>Varies</td>
<td>Low</td>
<td>Credit Union Member</td>
</tr>
<tr>
<td>Bank-Based Product</td>
<td>Varies</td>
<td>Low</td>
<td>Change Bank Account</td>
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Easy | Difficult
Change in pricing for a $300, two week loan before and after the Payday Loan Reform Act.

<table>
<thead>
<tr>
<th>Loan Type</th>
<th>Before Payday Loan Reform Act</th>
<th>After Payday Loan Reform Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payday Loans</td>
<td>573%</td>
<td>351%</td>
</tr>
<tr>
<td>Installment Loans</td>
<td>74%</td>
<td>387%</td>
</tr>
</tbody>
</table>

Source: Comparing the Cost of Credit Before and After the Monsignor John Egan Payday Loan Reform Act. 2006 Woodstock Institute
Blindfolded into Debt

75 percent of Americans qualify

Misleading terms and fees

“Universal Default”

Only the rate range is advertised

Convenience checks have different rates

Source: Blindfolded into Debt: A Comparison of Credit Card Costs and Conditions of Banks and Credit Unions. 2005 Woodstock Institute
Banking on Bounced Checks

Source: Banking on Bounced Checks: Federal Proposal on Bounce Protection Still Exposes Consumers to Hidden Fees. 2004 Woodstock Institute
Fair Pricing for Consumer Credit
Option: promoting affordable alternatives

Credit union alternatives:
APR for typical $300, 14 day loan

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<th>Credit Union</th>
<th>APR</th>
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<tr>
<td>Langley FCU</td>
<td>18%</td>
</tr>
<tr>
<td>Pentagon FCU</td>
<td>31%</td>
</tr>
<tr>
<td>Washington State Employees FCU</td>
<td>81%</td>
</tr>
<tr>
<td>Payday Loan in Illinois</td>
<td>351%</td>
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Small banks and CDCUs are payday loan alternative innovators

Limited scale and accessibility
Large banks and mainstream credit unions offer many of the services of banks.

Geographic FOMs allow them to serve entire regions.

Mainstream CUs
Austin Bank
Northside FCU
Southside FCU
### High Cost Consumer Credit

**Solution:** Identify barriers consumer credit alternatives

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**Ease of Access:**
- **Easy**
- **Difficult**
Why Research and Advocacy?
Problem: individual and community effects

Individual Effects

Community Effects
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