**The Middle Class Prosperity Project**

**Forum on Access and Opportunity: Predatory Financial Practices and Economic Injustice**

**Remarks by Rachel Schneider, SVP, CFSI**

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More than half of American adults – approximately 138 million – are struggling financially.[[1]](#footnote-1) While there are numerous causes, one of the primary drivers is volatile income, which affects about one-third of Americans.[[2]](#footnote-2) Their earnings fluctuate from month to month in both amount and timing, and in ways that are often outside of the households’ control – available hours or tips are unpredictable, a seasonal job winds down. Expenses often vary monthly as well and can be equally unpredictable. Such households experience swings in their ability to cover basic expenses, pay down debt or save for the future. This makes it difficult to achieve financial health.

To bridge the gap, some households can tap into a savings account or shift spending to a credit card. However, for the millions of Americans without an extra savings cushion[[3]](#footnote-3) or access to reliable credit,[[4]](#footnote-4) easy solutions are scarce. Absent better options, many turn to costly financial products to manage uncertain financial lives.

Every year, millions of American consumers use short-term loans of under $1000 – often called small dollar credit products – for quick access to cash.[[5]](#footnote-5) In 2013, the “very short-term” credit market – payday loans, pawn loans, deposit advance products, overdraft and refund anticipation loans – generated $21.9 billion of the $103 billion in total revenue generated within the underserved financial services sector in 2013.[[6]](#footnote-6)

Users of small dollar credit tend to feel that they do not have better options. Only 27% of SDC borrowers had a credit card, compared to 61% of non-SDC borrowers. And, for most of these consumers, spending down savings is not a viable replacement for SDC in the near-term, because about two thirds of SDC consumers report having no savings at all.[[7]](#footnote-7)

These products—payday loans, pawn loans, direct deposit advance loans, auto title loans, and non-bank installment loans—are often structured in ways that make repayment under the original terms of the contract unlikely. Lenders often do little or no underwriting, and require a quick turnaround balloon payment, which can lead consumers into a cycle of repeat usage and mounting debt. The Consumer Financial Protection Bureau’s research shows that about one third of borrowers pay off their loans as planned, but the remaining two thirds roll over their loans multiple times.[[8]](#footnote-8)

It is crucial that consumers be protected from predatory loan products. However, financial services can be a crucial element of helping families cope with the inevitable ups and downs in their financial lives. Therefore, it is not enough to limit the availability of bad products; we must replace them with better options.

The Center for Financial Services' (CFSI) Compass Principles – Embrace inclusion, Build trust, Promote success, and Create opportunity – provide standards for excellence in the design and delivery of financial services.[[9]](#footnote-9) To meet these standards, providers must strive to help solve the real financial challenges that people face. Consider, for example, those millions of Americans living with no financial cushion. Their need for immediate liquidity, certainty and control make alternative financial services attractive.

Payday loan borrowers have bank accounts, by definition, because the lender requires the borrower to provide a post-dated check as collateral. Today, however, checking accounts work best for households who can maintain a minimum balance, not for those whose accounts fluctuate up and down around zero. For households who need to know exactly how much they can spend real-time, checking accounts can be a frustrating source of risk in the form of potential overdraft and bounced check fees. Checks take days to clear, whereas prepaid cards, money orders and cash are immediate. They are also more precise. With cash, the consumer knows down to the penny exactly how much money she has at any given moment, critical data for someone living paycheck to paycheck. Many banking products are not designed to provide this level of control. Alternative products often are.

Over the last several years, several banks have entered the underserved marketplace with new products designed to offer greater immediate liquidity, certainty and control. This is to be applauded. However, the market environment offers disincentives to innovate: there is meaningful regulatory and reputational risk to getting it wrong. Providers do not have much room to experiment given the high level of scrutiny and criticism that any solution is subject to. Even solutions that are well intentioned or that represent improvements on existing products can have trouble finding sufficient growth capital and generating a wide range of business partners. As a result, while we have seen significant improvements in payments products for underserved consumers, the small dollar credit market remains uncompetitive, as many potential investors and lenders stay on the sidelines out of fear of being tagged as predatory lenders, in spite of the lure of the revenue opportunity.

There are a handful of high quality products in the marketplace that responsibly meet consumers’ short-term liquidity needs, but these products are still small-scale relative to demand.[[10]](#footnote-10) The lack of widely available, high quality credit options presents a major supply gap in the marketplace and is a significant pain point for underserved consumers.

That said, it would be a mistake to define this supply gap purely in terms of the number of people who are underserved. In fact, it could be argued that many borrowers are overserved. Instead, we need to understand that the relevant supply gap is an absence of products that are designed to build consumer financial health.

Financial health comes about when an individual’s daily systems help him or her to build resilience and pursue opportunities. Financial services that build financial health do more than facilitate a specific desired transaction in exchange for a fee. They facilitate that transaction in a way that leaves the customer better off, whether that means greater stability or more freedom to pursue their dreams. For example, three quarters of Americans have a savings account, but more than half do not have a planned savings habit and more than a quarter have less than $1,000 in liquid savings.[[11]](#footnote-11) This demonstrates a serious mismatch between what providers offer, which is a safe place to store funds, and what consumers need, which is more support in building, using and replenishing a buffer account. In the case of credit, borrowers need more than access to cash when they come up short. They need budgeting advice, ways to build their credit scores and guardrails that prevent overindebtedness.

It will take significant innovation in the marketplace to align products with the true consumer need.

The Center for Financial Services Innovation (CFSI) is the authority on consumer financial health, leading a network of committed financial services innovators to build better consumer products and practices. Our mission is to improve the financial health of Americans, especially the underserved, by shaping a robust and innovative financial services marketplace with increased access to higher quality products and practices. Through our Compass Principles and a lineup of proprietary research, insights and events, CFSI informs, advises, and connects members of its network to seed the innovation that will transform the financial services landscape.

We believe finance can be a force for good in people’s lives, and that serving the needs of consumers responsibly is ultimately more profitable for the financial services industry. Our vision is a financially-healthy America where people’s daily financial systems help them to build resilience and pursue opportunities.

1. Gutman, Garon, Hogarth and Schneider, “Understanding and Improving Financial Health in America,” March 2015, available at <http://www.cfsinnovation.com/Document-Library/Understanding-Consumer-Financial-Health>. Also see the Federal Reserve Board’s “Report on the Economic Well-Being of U.S. Households in 2013,” July 2014, available at <http://www.federalreserve.gov/econresdata/2013-report-economic-well-being-us-households-201407.pdf>, for a comprehensive look at household finances. [↑](#footnote-ref-1)
2. # Several studies have explored income volatility: Dynan, Elmendorf and Sichel, “The Evolution of Household Income Volatility,” available at <http://www.brookings.edu/research/papers/2013/01/household-income-volatility-dynan>; and Morduch and Schneider, “Spikes and Dips: How Income Uncertainty Affects Households,” available at <http://www.usfinancialdiaries.org/issue1-spikes/>.

   [↑](#footnote-ref-2)
3. According to the Federal Reserve’s Report on the Economic Wellbeing of US Households, over 50% could not come up with $400 to cover big expenses—like a medical bill or a car repair. According to CFED, 44% of the country lives with less than three months’ worth of saving, available at <http://assetsandopportunity.org/scorecard/assets/2015_Scorecard_Report_FinanciaAssetsIncome.pdf>. [↑](#footnote-ref-3)
4. The CFPB recently found that 26 million consumers are credit invisible, meaning they do not have any credit record, and another 19 million have unscored credit records, available at <http://files.consumerfinance.gov/f/201505_cfpb_data-point-credit-invisibles.pdf>. [↑](#footnote-ref-4)
5. Fifteen million borrowers a year, according to Levy and Sledge, “A Complex Portrait: An Examination of Small-Dollar Credit Consumers,” August, 2012, available at <http://www.cfsinnovation.com/CMSPages/GetFile.aspx?guid=f937e096-abcf-46cc-84d0-1c6c3aec2d3e>. [↑](#footnote-ref-5)
6. Wolkowitz, “2013 Financially Underserved Market Size,” December, 2014, available at <http://www.cfsinnovation.com/Document-Library/2013-Financially-Underserved-Market-Size.aspx>. [↑](#footnote-ref-6)
7. Levy and Sledge, “A Complex Portrait.” See also, Levy and Bianchi, “Know Your Borrower: The Four Need Cases of Small Dollar Credit Consumers,” December 2013, available at <http://www.cfsinnovation.com/Document-Library/Know-Your-Borrower-The-Four-Need-Cases-of-Smal-(1>). [↑](#footnote-ref-7)
8. CFPB Data Point: Payday Lending, March 2014 available at <http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf>. [↑](#footnote-ref-8)
9. The Compass Guide to Small Dollar Credit lays out detailed criteria, including: ability to repay and aligning the profitability of the lender with the success of the borrower. Brockland, Compass Guide to Small Dollar Credit, available at [www.cfsinnovation.com/Document-Library/The-Compass-Guide-to-Small-Dollar-Credit.aspx](http://www.cfsinnovation.com/Document-Library/The-Compass-Guide-to-Small-Dollar-Credit.aspx). [↑](#footnote-ref-9)
10. Forthcoming CFSI report. Sign up for CFSI’s newsletter at cfsinnovation.com to be notified about its release. [↑](#footnote-ref-10)
11. Gutman, Garon, Hogarth and Schneider, “Understanding and Improving Financial Health in America.” [↑](#footnote-ref-11)