

# Payday Lending: The Credit Union Way

By Nancy Pierce

May 2008

WHITE PAPER PRODUCED BY THE  
CUNA LENDING COUNCIL & NATIONAL CREDIT UNION  
FOUNDATION/REAL SOLUTIONS®



## About the CUNA Lending Council

The CUNA Lending Council is a community of credit union lending professionals dedicated to being the primary source of the best lending practices and educational opportunities in the credit union industry. Its 850 members from across the nation make up a network that represents credit unions of all types and sizes. The council is run by and for credit union executives and is managed by an executive committee elected by the members

## About the National Credit Union Foundation

The National Credit Union Foundation raises charitable funds, runs innovative programs, and makes impactful grants for America's credit union movement. NCUF's mission is to "promote and improve consumers' financial independence through credit unions." Among the NCUF programs achieving this mission:

**REAL Solutions®** – Helping millions of consumers gain access to affordable financial services, achieve financial literacy, grow savings, build assets, and buy homes.

**Development Education** – Leading training on cooperative principles in the modern consumer marketplace to overcome what credit unions identify as the greatest threat to their future: "the eroding of credit union philosophy."

**Social Impact Management** – Meeting a "triple bottom line" that benefits credit unions, members, and communities.

## About REAL Solutions ®

Nancy Pierce gathered knowledge of credit unions' innovative payday loan alternatives while serving as a Field Coach for REAL Solutions®, the signature program of the National Credit Union Foundation. "REAL" stands for "Relevant, Effective, Asset-building, Loyalty-producing" Solutions. The program works to help credit unions offer a wide range of products and services that have proven successful in serving working families with low wealth and modest means.

In the first 18 months as NCUF's signature program, REAL Solutions® are being offered by nearly 30 state credit union leagues and 500 credit unions. Thus far, payday loan alternatives are the most popular product. These solutions are often offered in combination with check cashing, volunteer income tax assistance, SAFE accounts, and/or financial education. The ultimate aim is to help underserved members move beyond basic transaction services to reach life-changing goals that will build assets for their families and for their credit unions.

According to the newly released Filene Research Institute report, *Back to the Future: Integrating Sustainability into Credit Union Strategy*, "The REAL Solutions initiative illustrates the type of strategy credit unions could adopt to successfully engage the underserved financial market." Researchers at Cornell University's Center for Sustainable Global Enterprise agreed that "This is important because underserved households--while at the bottom of the economic period now--represent future savers, future car-buyers, future homeowners, and future generations of credit union members."

## ***Table of Contents***

Executive Summary	4
Introduction	5
A Primer on Payday Lending	6
Credit Unions as a Response	8
Conclusions	20
Acknowledgements	21
About the Author	21
Resources	21
Appendix A: Payday Loan Product Worksheet	23
Appendix B: Payday Loan Models	27
Appendix C: Business Plan Considerations	28
Appendix D: A Creditorial	31

# Payday Lending: The Credit Union Way

## *Executive Summary*

The payday lending industry has enjoyed exponential growth over the last 12 years. Estimates of payday loan volume range from \$28 billion to over \$40 billion per year. That's a lot of loans when the average loan amount is \$300 and the term is typically for 14 to 30 days. Costs are very high, yet the industry reports 20 million customers. The profile of a payday loan borrower suggests an individual who is capable of making rational decisions, yet chooses to do business with a payday lender instead of a credit union, for whatever reason.

Are our credit union members using payday loans? YES! Somewhere between 10 percent and 20 percent of credit union members opt to do at least some of their business with payday lenders. Why? Perhaps it's fear of being turned down, knowing they may have credit issues. Perhaps the credit union's hours and location aren't convenient when the member needs the loan. But more likely, it's because the credit union doesn't have the right product—a small, short-term cash loan that can be accessed quickly and conveniently.

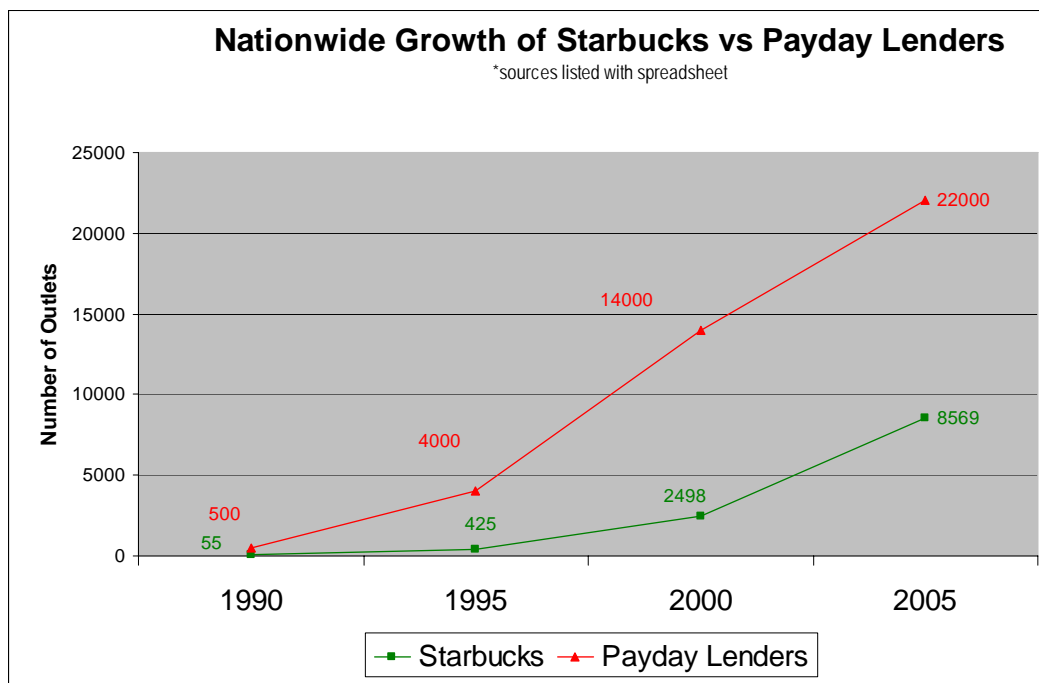
Why have credit unions shied away from payday-like loans? Perhaps credit unions fear offering such loans paints them with the same brush stroke as a payday lender, and that's an unsettling feeling. But credit unions are beginning to realize they need to be a part of the solution and cannot ignore what it is costing their members to do business with payday lenders. Credit unions can offer a better-valued product that is both empowering for their members and sustainable for the credit union.

This paper is intended to guide credit unions through the process of developing a payday-alternative loan product. It begins with a brief primer about the payday loan industry. It then goes through the many options credit unions need to consider when offering a short-term loan. Included in Appendix A is a payday loan product worksheet to guide credit unions through the decisions. Appendix B describes in spreadsheet format some of the existing models. Appendix C further lays out business plan considerations and operating procedures. Finally, Appendix D is a “creditorial” for the StretchPay model, describing how StretchPay has saved Ohioans millions of dollars, as an alternative to payday lending. It should help relieve some of the consternation credit unions might still feel about offering a payday lending product.

## Introduction

Quick! Name a business that had less than 50 locations in the U.S. in 1990 and now has over 26,000 locations and is projected to grow to 45,000 locations over the next few years. No, it's not Starbucks and it has nothing to do with cell phones or electronics.

It is the payday lending industry and, with the exponential growth it has enjoyed in recent years (see graph below), it is difficult to call it inconsequential and even more difficult to brush it aside as irrelevant to consumers. In fact, estimates of payday loan volume vary between \$28 billion and over \$40 billion per year<sup>1</sup> in loans to consumers, who for various reasons, choose to do at least some of their financial business with a payday lender.



Credit unions are beginning to see themselves as a response to the escalation of payday lenders—a response that can save payday borrowers lots of money and improve the economic well-being of communities. The National Credit Union Foundation and its signature program, REAL Solutions, are pleased with this response. REAL Solutions is a nationwide initiative to help consumers build financially strong families and communities through innovative products and services that serve as alternatives to high-cost and often predatory financial products and providers. REAL Solutions encourages credit unions to reach out to financially struggling families and households and be part of their recovery efforts.

---

<sup>1</sup> King, U., L. Parrish, and O. Tanik. 2006. "Financial Quicksand: Payday Lending Sinks Borrowers in Debt with \$4.2 Billion in Predatory Fees Every Year." Center for Responsible Lending.

A payday loan—the credit union way—is such a response. While REAL Solutions is not just about payday lending, those who serve as field coaches within participating states find that a payday loan alternative is what most credit unions choose as an initial focus, recognizing many of their members are caught in the debt spiral. This paper reflects the information learned from credit unions and service providers to the payday industry, while working as a field coach for REAL Solutions.<sup>2</sup>

## *A Primer on Payday Lending*

### **Profile of Payday Loan Borrower**

So, who chooses to do business with payday lenders? First and foremost, borrowers must have a steady income and active checking account. Payday lenders generally require a recent pay stub and checking statement before granting a loan. Other characteristics of the typical payday loan borrower are:

- 52% have incomes between \$25,000 and \$50,000
- 68% are under 45 years of age (median age is 32)
- 82% have a high-school diploma or better; 52% have some college education or a degree
- 50% have been in their jobs for three years or less; 23% in jobs over five years
- 42% own their homes
- 62% are females with children

They are not necessarily low-income borrowers—over half have incomes between \$25,000 and \$50,000. Payday loan borrowers also tend to be younger, with the median age being 32.

Does this profile conjure up images of a victimized group or gullible prey? Does it reflect a group unable to rationally make the decision to choose a payday lender in lieu of a credit union or traditional lending institution? Hardly. Yet for various reasons 10 million people choose to get a payday loan<sup>3</sup> rather than a better-priced product from their bank or credit union. Why? One study reported 60 percent of payday loan customers said they were “maxed out” on their credit cards and that difficulty in obtaining additional credit drove their demand for payday loans.<sup>4</sup> This might explain why some credit union members are turning to payday lenders, as well, if they have been denied or fear being denied additional credit because of deteriorating credit history.

---

<sup>2</sup> To learn more about REAL Solutions, see contact information for Lois Kitsch, national program manager, in the “Acknowledgements” section of this paper.

<sup>3</sup> Morgan, D., and M. Strain. “Payday Holiday: How Households Fare after Payday Credit Bans.” Federal Reserve Bank of New York Staff Reports, November 2007.

<sup>4</sup> Elliehausen, G., and E. C. Lawrence. 2001. *Payday Advance Credit in America: An Analysis of Consumer Demand*. Credit Research Center Monograph No. 35. Washington, D.C.: Georgetown University.

## **What Is a Payday Loan?**

Payday loans are simply what the name indicates—a short-term cash loan until the borrowers' next payday. Although costs are very high, the loan is quick and convenient. The borrower typically writes a post-dated check that includes the loan fees that is used as “collateral” for the loan, or signs an ACH authorization to debit the borrower's account on payday.

The average loan is \$300 and the term is typically for 14 to 30 days. Fees vary but average between \$15 to \$20 per \$100. For a 14-day loan at \$20 per hundred, the APR is 520 percent! The APR, as most payday lenders are quick to point out, assumes the borrower will have the loan for the whole year and will be paying \$20 every two weeks.

For some payday loan borrowers, that isn't far from the truth. According to the Center for Responsible Lending, 60 percent of payday loans go to borrowers with 12 or more transactions per year.<sup>5</sup>

It is the quoted APR that gives these loans a bad rap and causes consumer groups like the Center for Responsible Lending to try to put payday lenders out of business. Yet, studies indicate that 92 percent of borrowers are aware of the finance charge and many recall it being disclosed as an APR.<sup>6</sup> So while the cost of a payday loan may give some consumer groups heartburn, it is not a deterrent to the many borrowers who get these loans.

A myth exists that payday lenders do not obtain any kind of credit check on their borrowers. Most use a subprime credit bureau such as Teletrack to check if the borrower has any other outstanding payday loans and if there are any past due and uncollected loans to the borrower. Unlike traditional credit bureaus, the subprime bureaus operate in real time because of the very short nature of the loans. Reporting once a month on a borrower's payment history doesn't work when the loan is typically for 14 days.

## **Alternatives to Payday Loans**

Let's consider some alternatives for the working mom who is short \$100 until payday, 14 days from now. She could get a \$100 payday loan, pay \$15, and the APR for that two-week loan would be 391 percent..

She could also choose to write a bad check and pay an average of \$48 in NSF and merchant fees. That would be a comparable APR of 1,251 percent!

Even if she has courtesy pay with her credit union, the average fee is \$25, or an APR of 650 percent. Another option for her might be to not pay the \$100 minimum balance due on her credit card, resulting in a \$26 late fee—678 percent. If she chooses to not pay her

---

<sup>5</sup> King, U., L. Parrish, and O. Tanik. 2006. “Financial Quicksand: Payday Lending Sinks Borrowers in Debt with \$4.2 Billion in Predatory Fees Every Year.” Center for Responsible Lending.

<sup>6</sup> Elliehausen, G., and E. C. Lawrence. 2001. *Payday Advance Credit in America: An Analysis of Consumer Demand*. Credit Research Center Monograph No. 35. Washington, D.C.: Georgetown University.

\$100 utility bill which may result in a \$50 late or reconnect fee, that's a comparable APR of 1,304 percent!

The argument can be made that by securing a payday loan to solve her cash flow needs, this woman is taking a proactive approach to her financial dilemma.

The Center for Responsible Lending indicates the 11 states that banned or limited payday lending saved consumers \$1.4 billion in fees in 2006. But eliminating local payday lending activity does not eliminate the need for emergency cash loans. People still come up short prior to payday and the center does not address how these consumers managed their cash-flow problems. If they had to use one of the other alternatives, or had to drive to an adjoining state that made payday loans, or used the Internet to get an even higher-priced loan, it is possible consumers in these states paid even more to solve their cash-flow problems.

In fact, a 2007 study by the Federal Reserve Bank of New York found that households in Georgia and North Carolina, two states with payday loan bans, bounced more checks following the bans on payday lenders. The Atlanta Federal Reserve check processing center returned an average 1.2 million more checks per year following the ban than before the ban took place.<sup>7</sup> The study calculated that depositors paid an extra \$36 million per year to cover bounced checks, at an average cost of \$30 per item. In addition, complaints to the Federal Trade Commission (FTC) against debt collectors increased 64 percent in Georgia after the ban, a measure of households' welfare when they become sufficiently bothered to appeal for protection against abusive practices.

Lower-income and low-wealth households are not helped when their financial options are limited or eliminated. They are helped when they are given more and better options. And credit unions need to be a part of the response to the short-term cash needs many households experience.

A 2003 survey by MetLife found that 87 percent of households with incomes under \$30,000 live paycheck to paycheck; further, 65 percent of households with incomes between \$30,000 and \$50,000 are in the same boat. These households have critical needs for short-term loans when cash emergencies arise.

## ***Credit Unions as a Response***

Are your members using payday loans? YES! Between 15 and 25 percent! About 20 percent of checks used as collateral for payday lenders are written on credit union checking accounts. Similarly, those credit unions that have run their membership data

---

<sup>7</sup> Morgan, D., and M. Strain. "Payday Holiday: How Households Fare after Payday Credit Bans." Federal Reserve Bank of New York Staff Reports, November 2007.

bases through Teletrack to look at PDL “hits” over some period of time, report between 15 to 25 percent of their members have or are using payday loans.<sup>8</sup>

Are your employees using payday lenders? Probably. Look at the profile once again of a payday loan user. It fits the profile of most credit unions’ frontline staff, particularly tellers and MSRs.

Credit unions used to make payday loans. In fact, that was a large part of their business in early years, helping employees within their employer-based memberships get by until payday. Credit union people who have been around for a few years can tell many stories about walking through the worksite and making small loans to workers out of hand-carried cash boxes, after securing their signatures on brief notes.

But somewhere along the way credit unions decided small loans were unprofitable and walked away from them. So the payday lenders came along, recognized a niche market and need, and learned that small, short-term loans could be made profitably. Now many credit unions are recognizing they can be a better solution and are adding payday-like products to their loan portfolios.

A study by the Colorado Uniform Consumer Credit Code found that in the first six months of 2007, almost 17 percent of payday loan users in that state were indebted every day. This 17 percent accounted for over 31 percent of the payday loan volume.<sup>9</sup> If they borrow once, they are likely to borrow 8 to 12 times a year. In fact, the study found that those with 12 or more loans in the preceding 12 months accounted for two-thirds of the total loan volume.

### **Why Offer a Payday Loan Alternative?**

Even as credit unions discover it is difficult to help people out of the debt cycle, they realize they can provide safe-harbor products for their members that can give them access to emergency cash, yet do so at a better value for members and still make the product sustainable for the credit union.

Many credit unions are also recognizing a payday-like product is a way to demonstrate the credit union difference by providing the community with a lower-cost alternative to payday loans. Other advantages for offering a payday-like loan product include:

- Provides an affordable alternative for a product members want
- Generates revenue
- Grows membership
- Attracts younger members
- Improves the economic well-being of the community

---

<sup>8</sup> The cost to do a “data scrub” or what Teletrack calls “retro-active appends” is \$500. For more information about Teletrack, see “Resources” section.

<sup>9</sup> Colorado Uniform Consumer Credit Code. “Payday Lending Demographic and Statistical Information: July 2000 through December 2007.”

- Does the right thing
- Generates political good will

### **Payday Loan Considerations**

Implementing a payday loan or payday-like loan product involves many decisions, ranging from determining the target market, pricing strategy, and risk tolerance to identifying the credit union's philosophical commitment to getting people out of the debt cycle. The credit union's board and senior staff members should participate in these debates and decisions. But all staff members, including frontline personnel, need to understand what the credit union wants to achieve by introducing a non-traditional loan product, especially one associated with payday lenders.

A "Payday Loan Product Worksheet" prepared by REAL Solutions is included in Appendix A and should help a credit union work through the decisions to be made in an orderly fashion. The rest of this paper goes through each of the considerations and offers suggestions and cautions, as necessary, to help credit unions put together a worthy and sustainable product.

### **Who Do You Wish to Serve?**

Who will be the likely target market for your credit union's loan product? Will it be current members using payday lenders, potential (new) members who are currently standing in the payday loan lines, or members who aren't using payday loans but may have a need for short-term emergency cash needs?

Most credit unions choose to start with existing members either using payday lenders today or those that may have a need in the future for a short-term, small loan. These members already have a relationship with the credit union and, as such, minimize some of the riskiness of the loan.

These credit unions generally have a minimum membership requirement, such as being a member for at least 30 to 90 days. Others may require a checking account or direct deposit relationship with the credit union.

Those credit unions that want to increase membership and reach out to those standing in payday loan lines should be fully aware of the risks they may encounter and price accordingly.

### **What Is Your Pricing Strategy?**

How will your credit union need or want to price its payday loan product? If the decision is that the product should add to the credit union's bottom line, the credit union should determine what it will cost to make the loan. As you work your way through the questionnaire, you will have opportunities to make decisions that can either add to the cost of your product or make it more efficient. But efficiency also has its detriments.

Efficiency usually means less face time or intervention points with members. This is where the credit union's philosophical commitment towards getting members out of the debt spiral has meaning. Considerations for establishing a pricing strategy include:

- Must the product be profitable?
- Must the product break even?
- Is the product being offered as a community service? Is it okay to subsidize the product?
- If the product is subsidized, for how long and to what extent?
- If the product is subsidized, what is the long-term strategy?

If your credit union's decision is to offer the product at a loss, there should be discussion regarding how long to subsidize it and at what cost. Some credit unions have found themselves with such value-priced and appealing loan products that their expenses increased substantially with added lobby traffic and cash needs. REAL Solutions cautions credit unions to offer the product at a price that makes it sustainable and a good business decision for the credit union. The last thing a credit union wants is a product that distresses and demoralizes employees because of the extra burdens it puts on them, especially if the product is a money loser. If the product is adding to the bottom line, make sure employees are aware of it.

### **What Type of Loan Product?**

Will the product be an overdraft or line-of-credit, or will it be a small closed-end signature loan? Some examples of line-of-credit products that are featured in Appendix B include the StretchPay, SALO, and Freedom loans.

If the decision is to use a line-of-credit product, the next decision is whether the loan must be paid in full before another advance is allowed. StretchPay and SALO are products that require the loan be paid in full. The Freedom loan allows additional advances up to the maximum line. Examples of closed-end, small consumer loans are the Better Choice and GoodMoney products.

A line-of-credit product is generally more efficient and, once set up, does not require a lot of staff intervention, except for perhaps a once-a-year renewal process. A closed-end loan enables more face time—time that can be used to counsel or interview the member.

### **What Underwriting Verifications Will You Use?**

What underwriting verifications will your credit union want to use for its payday loan product?

Most credit unions require some form of income and employment verification. If the member already has direct deposit with the credit union, then this step is easy. Some credit unions, as part of the qualifying criteria for a payday loan product, require direct deposit. If not, then at a minimum, require a current pay stub. Your credit union will have

to then decide if you make a call to the employer to verify employment or accept the pay stub as proof.

Will you require a minimum length of employment? This decision varies for credit unions depending on their field of membership, but most will have some minimums that range from 30 to 90 days.

Most credit unions choose not to run a credit check for a payday-like loan product, knowing many borrowers will likely have credit challenges, and eliminating this step reduces expenses. Other credit unions run a credit check to see if the borrower may qualify for a better-rate loan, for counseling purposes, for cross-sales opportunities, or to ensure the borrower is not in bankruptcy. Some also use the credit bureau information to track demographic information about their product users, such as credit score. Other credit unions use a subprime credit bureau such as Teletrack to see if the borrower has used payday lenders in the past, has any current loans outstanding, or if the borrower caused a loss to any subprime lender.

### **What Terms Will You Offer?**

Now it's time to decide if your loan will look like a true payday loan to be repaid on the member's next payday, or allow members a period of time to repay the loan back. There is a lot of debate and no clear-cut answers as to whether people who use payday loans are better off repaying the loan on their next payday or having the loan amortized over some period of time. Here are a few considerations:

- When must the loan be repaid?
- Number of outstanding payday loans at any one time?
- Number of loans within a period of time?
- Must the loan be paid in full before another advance is made?

One position is that people who are not quite living paycheck-to-paycheck will continue to manage (or mismanage) their money in that way for at least some period of time, and making them a small loan over an extended period won't change behavior. In other words, they will still come up short prior to payday and will need a payday loan.

Then there is the counter-argument that the reason payday loan users are caught in a debt spiral and need to continuously repay the fee to extend the loan another 7 to 14 days, is because most households don't have an extra \$200 to \$500 in their paychecks in order to repay the loan in one payment.

The best solution to the argument may be to let the borrowers decide what the best terms are for them. Give them options from 7 to 90 days. Loan terms that exceed 90 days may be necessary for larger loans (for example, if the credit union is paying off more than one payday loan for a borrower). But most credit unions will stay within a 90-day term for a payday-like loan product.

How many outstanding payday loans will you allow a member to have at any one time from your credit union or with all payday lenders? If you have opted to use a subprime credit bureau you will know if your member has outstanding payday loans. Again, the majority of credit unions usually allow a member one payday-like loan with the credit union, or perhaps more if the person is using other payday lenders, but not to exceed a certain percentage of the borrower's income.

Will your credit union limit how many payday loans it will allow a member to obtain within a specified period of time, such as 6 or 12 within a 12-month period? Some credit unions intervene after three or four advances and offer financial counseling assistance to the member. Others don't put any limitations on the number of advances figuring the product is a better solution than a payday lender, whom the borrower will probably turn to if he/she can't get another advance at the credit union.

Will you require a payday loan be paid in full before another loan advance is made? Your credit union may have already made this decision in the earlier discussion regarding closed-end versus open-end loan options. If not, now is a good time to have that discussion.

### **Minimum and Maximum Loan Amounts**

The majority of credit unions use \$50 to \$100 as a minimum and \$500 is a popular maximum amount. Credit unions that serve a closed-field of membership where wages are above normal may have higher maximums, such as \$750 or even \$1,000. Note that even these credit unions whose members have wages above average recognize a need for a payday-like product.

Some credit unions will set the maximum amount as a percentage of the member's direct deposit or net pay. Some state payday loan laws limit loan amounts to a percentage of income, up to a specified cap. For example, New Mexico's payday loan law specifies that all outstanding payday loans cannot exceed 25 percent of the borrower's monthly *gross* income or \$2,500, whichever is less. By contrast, Montana's law limits payday loans to \$300 plus fees, but not to exceed 25 percent of monthly *net* income.

### **What Do You Charge?**

First and foremost, what can the credit union legally charge? A federally chartered credit union cannot charge more than 18 percent APR. State-chartered credit unions should review their statutes to know what can legally be charged in the way of interest rates and fees.

Whether fees need to be disclosed as part of the finance charge is another consideration, particularly for federal credit unions banging up against an 18 percent APR limit. The 135-page Truth in Lending Manual can be accessed at [www.occ.treas.gov/handbook/til.pdf](http://www.occ.treas.gov/handbook/til.pdf). Page 100 of the manual contains a nicely laid out

“Finance Charge Chart” that discusses when charges need to be included in the finance charge and when they can be excluded.

Charges that can be *excluded* are application fees, *if charged to all applicants*, whether or not credit is actually extended. Many federally chartered credit unions, as well as state-chartered credit unions, use an application fee to cover the application process expenses. These typically range from \$10 to \$25. Because the fee must be assessed whether credit is granted or not, credit unions are advised to make their underwriting criteria available to members ahead of the application process so members can pre-qualify themselves on their own.

Fees charged for participation in a credit plan are also excluded from the finance charge calculation. For example, the StretchPay and Freedom models have annual fees attached to them to participate in the loan product. These are not included in the APR. Fees can be charged on a monthly or annual basis. However, if fees are charged and then refunded based on a member’s usage of the product, these fees would have to be included as a finance charge.

### **How Hard Do You Work at Getting Members Out of the Cycle?**

Do consumers learn from past debt spiral experiences with payday loans? Unfortunately, many do not. Anecdotally, credit union employees talk about members they have “saved” by paying off their payday loans, only to have them revert to those sources again later. Why? Perhaps they are embarrassed to return to the credit union to confess to yet another crisis. Perhaps they think they have learned from the prior experience and will not get in “over their heads” again. Some strategies for getting members “out of the debt cycle” include:

- Requiring members to complete some form of financial education
- Encouraging members to complete some form of financial education
- Requiring members to put some loan proceeds into a restricted savings account
- Encouraging members to put some loan proceeds into a restricted savings account

Kirk Chewing, vice president of TranDotCom Solutions, a software vendor for the payday loan industry, states that consumers who get caught in the payday loan cycle often are in that state of flux for two to three years. It often takes a lifestyle change for them to emerge, such as getting married, so that there are two incomes for the household, or a new and better job or a pay increase. If that’s the case, does the credit union just provide a safe harbor for the member until he/she is ready or able to move out of the cycle? Or does the credit union actively intervene to compel/encourage members to move towards a more secure future? Some credit union executives argue adamantly for intervention—that it’s the credit union philosophy and difference to help members make sound financial decisions. Others argue just as adamantly against intervention—it only sends them back to the payday lender.

There is no right or wrong answer. It depends on the credit union's philosophical disposition to intervention: Is it patronizing and meddling, or is it an investment in a member's well-being?

With all this said, let's look at some considerations and some examples of what credit unions are doing to tie their payday lending product to methods of getting members out of the cycle.

Few credit unions try to make financial counseling mandatory as part of a payday-like loan product. In fact, State Employees Credit Union (SECU) initially required members who used its SALO product to receive budget counseling through BALANCE, a financial fitness program provider, at no cost to the member. But when the credit union realized this had little effect on its members, it turned to mandatory savings instead.

GoodMoney offers its members a certificate worth \$50 for financial counseling at the third loan renewal. Ken Eiden, the CEO of Prospera Credit Union, acknowledges that although 1,586 certificates have been issued, only 27 individuals have followed through with counseling. But, looking at the rosy side of the picture, 27 individuals may have been helped that would not have otherwise fallen into the safety net.

Savings programs seem to have somewhat better success. As mentioned earlier, SECU moved from an emphasis on budget counseling to an emphasis on savings to help members achieve financial independence. Five percent of each loan advance must be deposited into a special savings account. While the savings is available to members when the loan is paid off, members who withdraw the funds are not eligible to use the SALO product for six months. That appears to be incentive enough for many members to maintain their savings balances. The credit union reports \$13.2 million in the SALO special savings account and about 72,000 members currently using the SALO loan. That averages \$183 per borrower. However, Phil Greer, senior vice president of loan administration, reports that over 1,000 members have accumulated over \$1,000 in their restricted savings accounts. In fact, one member has over \$3,000 in savings, but continues to use the SALO product because that is his way of saving money.

Pennsylvania's Better Choice product also includes a required savings component (10 percent of the loan amount which becomes available to members when the loan is repaid), typically within 90 days. However, Diane Powell, director of communications at the Pennsylvania Credit Union Association, reports that at least anecdotally she hears that most members withdraw the money on day 91. But, she adds, for a 90-day, \$500 loan, the savings plus interest amount to \$52.25. "That can buy a tank of gas or groceries for a week. It's not an insignificant amount of money for most households, and money they otherwise wouldn't have," she says.

### **What about Relationship Pricing?**

Some credit unions prefer the carrot approach to using credit union-provided products and services rather than the stick approach; that is, provide incentives rather than make

usage mandatory. Does your credit union encourage members by giving a discounted interest rate or fee if they:

- Have checking accounts with the credit union?
- Have PRD or direct deposit with the credit union?
- Complete some form of financial education?
- Put some loan proceeds into a restricted savings account?

For example, the Freedom A loan offered by St. Louis Community Credit Union has a lower annual fee and interest rate than the Freedom B loan (\$25 annual fee versus \$40 annual fee and 25 percent APR versus 27 percent APR, respectively), but requires direct deposit. Members can decide how important direct deposit is to them or those without access to direct deposit can still use the credit union product.

XtraCash, a credit union payday loan product, is priced between \$9 and \$15 per \$100, depending on the discounts borrowers choose by using the credit union's checking or savings account and/or by participating in financial counseling.

Some credit unions are experimenting with putting the reduced fees into a restricted savings account to help members build savings, with the eventual goal of moving them out of the debt spiral.

### **What Is Your Risk Tolerance and Strategy?**

This may be the most important decision for your credit union to make—determining how much risk you are willing to accept and how to mitigate the risks so they are manageable and tolerable. Some risks can be minimized through your underwriting criteria; others can be reduced by pooling your risk with other credit unions, limiting the loan dollars you will extend for the product, or setting up a special reserve to cover losses.

The payday lending industry's losses run between \$2 and \$4 per \$100. Prospera Credit Union's GoodMoney product, a true payday loan, reports losses of \$4.36 per \$100.<sup>10</sup> So if your credit union is planning to offer a payday loan product to those people currently using the payday lender down the street, expect similar losses and price accordingly.

To establish your own risk strategy, consider the following questions:

*Will you require a minimum qualifying time?*

If you serve a closed field of membership or a small community where everyone knows everyone, you may not need a membership eligibility requirement. But if you serve a large community where, when word hits the street the credit union is giving away free money, lots of folks will be lining up to get their fair share, you may want to consider a

---

<sup>10</sup> For contact information regarding the GoodMoney product which Prospera Credit Union plans to offer to other credit unions, see the "Resources" section of this paper.

membership eligibility criterion. As noted earlier, 30 to 90 days are common qualifying periods.

*Will you require a minimum length of employment?*

As discussed earlier, this decision varies again by credit union depending on its field of membership, but 30 to 90 days or even longer is not uncommon. To reduce risk, it is wise to have the member at least past his/her probationary or introductory work period.

*Will you require direct deposit or a credit union checking account?*

Requiring direct deposit as an underwriting criterion is one of the best ways to mitigate risk. Credit unions that require direct deposit report minimal losses. State Employees Credit Union, which does require direct deposit, calculates its loss ratio as a percent of dollars loaned; its loss ratio was 0.21 percent in 2007. Another loss strategy is to require a credit union checking account, and even better, an active checking account where one or two deposits have been received.

*Will you require a minimum credit score?*

As stated earlier, most credit unions offering a payday-like loan product do not use credit scores as an underwriting criterion. Those who do get credit reports use them for other purposes. However, a minimum score would be a method of reducing risk.

*Will you require a post-dated check or an ACH pre-authorization?*

If you are offering a true payday loan product, you probably will want to do so. Users of payday loan stores are used to doing this and will not balk at such a request. If not a post-dated check or ACH, consider how the member will repay the loan on payday.

*Do you want to pool the risk among several credit unions?*

The StretchPay model uses this method to reduce 90 percent of the risk to any participating credit union. Credit unions join a collaborative (CUOSI) and submit the annual fees (\$35 or \$70) they collect from StretchPay borrowers to CUOSI. In return and after following expected collection practices, credit unions are reimbursed up to 90 percent of any losses.<sup>11</sup>

*Do you want to use a third-party vendor that accepts any risk?*

XtraCash is an example of such a vendor, operating as a for-profit CUSO.<sup>12</sup> Income to the credit union is reduced considerably, but so is the risk.

---

<sup>11</sup> For contact information regarding the StretchPay model, see the “Resources” section of this paper.

<sup>12</sup> For contact information regarding XtraCash, see the “Resources” section of this paper.

*Do you want to limit the dollar amount or percent of your loan portfolio that will be invested in the product?*

One credit union that is about \$242 million in assets has set aside \$500,000 for its payday-like product. But \$500,000 can make a lot of \$300 loans, especially if they turn over every 30 to 90 days.

*Do you want to fund a special loan loss reserve to cover anticipated losses?*

Depending on how your credit union plans to handle risk, a guideline might be to anticipate losses from one to three percent of loans made. For the credit union that has set aside \$500,000 for its loan product, that would result in anticipated losses between \$5,000 and \$15,000.

### **Some Final Considerations**

Here are a few more things to consider before rolling out the product.

*What do you name the product?*

For some credit unions, this could be the biggest challenge. Marketers like cute, clever names. Some executives and board members don't want a name that sounds anything like a payday loan; other executives and board members argue that if it doesn't sound like a payday loan, no one will recognize it for what it is. One solution might be that used by Kootenai Valley Federal Credit Union in Montana. It calls its loan the "NOW Loan" with a tagline that reads: "The smart alternative to 'payday' loans!"

*How do you market the product?*

Responses to this question have ranged from "We don't plan to tell anyone" to "We will put a neon sign on the roof of our building that says 'We Make Payday Loans.'" Obviously, there is a lot of room in between. Most credit unions choose to start with a soft rollout with lobby signs and fliers letting their members who come into the branch know of the new product. The credit union's newsletter is another easy way to make members (at least those who read the newsletter) aware of the product. Most credit unions report that "word of mouth" is one of the best ways for word to spread about the new product—especially within credit union SEGs or sponsor groups, where co-workers will tell their friends about cheaper alternatives to payday loans, if they are frequenting payday loan stores. Another easy method is to market to those members you know are using payday lenders because they show up on your ACH listings or their payday loan checks are cleared through your item processing center. However, market with caution because you don't necessarily want your members to know that you know their habits.

*Are there any technology limitations?*

For example, if you are setting your product up as a line-of-credit and it has to be paid in full before any further advances, can your data system manage this requirement? If you want to automate the process as much as possible, what limitations need to be overcome? Again, if the product is a line-of-credit that has to be renewed annually, is there a way to pre-notify the member that the renewal date is approaching before the member finds himself/herself cut off?

*Will collection techniques be different from traditional loans?*

There will probably be some differences. For example, collection efforts for the GoodMoney product actually start before the due date. Similar to some payday lenders, Prospera Credit Union makes a courtesy call to borrowers a day or two before the loan is due to remind them of payment. Similarly, Wright-Patt Credit Union with its StretchPay loan sends out an automated pre-call seven days before the loan due date to remind the member of the payment amount. When the loan is 16 days past due, the first collection call is made. StretchPay loans at the credit union are recommended for charge off when they are 60 to 90 days delinquent (usually three to six calls have been made in this time frame to the borrower).

Other credit unions that make a lot of C and D paper loans have aggressive collection practices for subprime loans to borrowers with risky credit. Delinquent accounts are called the first day they become past due.

*How will you educate staff about the new product and its target market?*

Even if staff members have been involved in the debate and decisions regarding your new payday-like loan, they should still be exposed to some sensitivity training prior to rollout. And if they haven't been involved, training is even more critical. They need to understand why the credit union is introducing a non-traditional loan product, who they are trying to reach and help, and the important role employees play in its success. Delivering good member service has always been a priority for most credit unions, including treating people with respect and dignity. Those using the new product will be as individual as the general population. But many will be going through crisis situations and employees should understand how compassionate communication and listening skills can turn what may be an uncomfortable situation for some members into a very positive and satisfying experience. The result can be very loyal members.

*Will your credit union have to comply with the new Department of Defense rules to service members and their dependents?*

It will, if the loan product meets the following description: closed-end transactions having a term of 91 days or less and the amount financed is not more than \$2,000, and where the borrower is required to 1) provide a check or payment instrument for more than one day, or 2) authorize the creditor to initiate a debit or debits to the covered

borrower's deposit account (by electronic fund transfer or remotely created check) after one or more days.

If the loan product meets all of those requirements, then the credit union is a "covered creditor" and may not offer a loan product that has a MAPR (Military Annual Percentage Rate) that exceeds 36 percent to "covered borrowers," generally referred to as military personnel and their dependents. More information on this new rule can be found in CUNA's e-guide at [http://www.cuna.org/compliance/member/eguide/eguide\\_svcmember\\_loanrate.html](http://www.cuna.org/compliance/member/eguide/eguide_svcmember_loanrate.html).

## *Conclusions*

Hopefully, this step-by-step description has helped you develop a payday-like loan product that fits your membership and credit union needs. The purpose of this white paper is to provide you with the means to minimize your risks to stay within your credit union tolerance level and to help you price your product adequately to cover those risks.

Field coaches for REAL Solutions suggest starting conservatively if your credit union is unsure of what risks it may face given its field-of-membership. With some history and experience you can always expand the program. It is more difficult to cut back a program or product that becomes very popular and successful with members, but may be priced inadequately for risks or overhead expenses.

If you are ready to launch a payday-like product—congratulations! You have become a part of the credit union response to payday lending! The National Credit Union Foundation (NCUF) and REAL Solutions encourage you to track your borrower and loan volume statistics to help NCUF measure credit union impact efforts at serving low-wealth households. If your credit union is already a REAL Solutions partner, you may already be participating in tracking efforts. If not, contact your state league or association to see if your state is a REAL Solutions partner and how you can participate. If your state is not part of REAL Solutions, contact Lois Kitsch, national program manager for REAL Solutions at [LKitsch@ncuf.coop](mailto:LKitsch@ncuf.coop), to find out how you can participate in tracking efforts. Consumer groups, government agencies, community-based organizations, and the credit union system are all eager to learn about the scope and impact of payday lending—the credit union way.

## ***Acknowledgements***

The author would like to thank the National Credit Union Foundation's REAL Solutions national program manager and field coaches who provided material and assistance with this project:

Lois Kitsch, national program manager  
Larry Blanchard, field coach  
Melissa Farley, field coach  
Vicki Joyal, field coach  
Mark Lynch, field coach  
Bill Myers, field coach

## ***About the Author***

Nancy Pierce is president of Tipton Research Group in Kansas City, Missouri, which provides research and consulting services to the credit union industry. She is a 25-year veteran of the credit union industry and served as president of Mazuma Credit Union in Kansas City and as chairwoman of both the Missouri Credit Union Association and the Credit Union National Association. Following her retirement from Mazuma Credit Union, Pierce received her Ph.D. in Consumer and Family Economics from the University of Missouri-Columbia in 2004. She currently serves as a field coach for the National Credit Union Foundation's REAL Solutions program in Montana, Texas, Colorado, and Wyoming.

## ***Resources***

Colorado Uniform Consumer Credit Code. "Payday Lending Demographic and Statistical Information: July 2000 through December 2007."

Elliehausen, G., and E. C. Lawrence. 2001. *Payday Advance Credit in America: An Analysis of Consumer Demand*. Credit Research Center Monograph No. 35. Washington, D.C.: Georgetown University.

GoodMoney. Prospera Credit Union. For more information contact Ken Eiden at 920-882-4790 or [Ken.eiden@myprospera.com](mailto:Ken.eiden@myprospera.com).

King, U., L. Parrish, and O. Tanik. 2006. "Financial Quicksand: Payday Lending Sinks Borrowers in Debt with \$4.2 Billion in Predatory Fees Every Year." Center for Responsible Lending.

Morgan, D., and M. Strain. "Payday Holiday: How Households Fare after Payday Credit Bans." Federal Reserve Bank of New York Staff Reports, November 2007.

StretchPay, Ohio Credit Union League. For more information contact Becky Hart at 800-486-2917 or [rhart@ohiocul.org](mailto:rhart@ohiocul.org).

Teletrack. For more information contact Paul Worden at 800-729-6981 or [pworden@teletrack.com](mailto:pworden@teletrack.com).

TranDotCom. For more information contact Kirk Chewning at 678-355-1551, ext. 1203, or [kchewning@tdcemail.com](mailto:kchewning@tdcemail.com).

XtraCash. For more information contact Lon Neofotist at 913-310-9292, ext. 5621, or [lneofotist@xtracashllc.com](mailto:lneofotist@xtracashllc.com).

# Appendix A



## Payday Loan Product

### Worksheet

1) Identify whether each of the following is a reason why your credit union is interested in offering a payday loan product:

	Yes	No	Don't know
To save members money on payday loans	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
To build a credit history for borrowers	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
To attract new members	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
To build political capital and the CU brand	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
To provide a community service	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
To help members escape the payday lending trap	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

2) Starting out, who will be the likely target market for your credit union's payday loan product?

- Current members
- Potential (new) members
- Both current and potential members

3) How will your credit union need/want to price its payday loan product?

- The product must be profitable (charge an application fee plus interest)
- The product must break even (charge an annual fee plus interest)
- The product could be offered at a loss (charge an interest rate without a fee)  
If at a loss, for how long? \_\_\_\_\_
- Don't know

4) Will you need/want your credit union's payday loan to be a line-of-credit or simply a small consumer loan?

- Line-of-credit (Open-ended)
- Small consumer loan (Closed ended)
- Don't know

**5) Which of the following verification(s) will your payday loan product require?**

- Income/employment verification
- Credit report for demographic purposes, but not for underwriting
- Sub-prime credit check (i.e., to identify whether borrower is using other payday lenders)
- Credit report for underwriting purposes
- Don't know
- Other (please specify)

**6) What is your preferred minimum loan term for this payday loan product?**

- No minimum loan term
- 7-day loan term
- 14-day loan term
- 21-day loan term
- 30-day loan term

**7) What is your preferred maximum loan term for this payday loan product?**

- 60 days (balloon or amortized?)
- 90-day (balloon or amortized?)
- 120-day
- One-year
- Don't know
- Other (please specify)

**8) What is your preferred minimum loan amount for this payday loan product?**

\$ \_\_\_\_\_

**9) What is your preferred maximum loan amount for this payday loan product?**

\$ \_\_\_\_\_

**10) Would you prefer to utilize one or more fixed dollar values, or a percentage of an applicant's net pay to determine the amount of your payday loans?**

- Prefer that our payday loan amounts are of fixed size (e.g., we'll make loans in one or two denominations)
- Prefer that our payday loan amounts vary based on the percentage of a member's net pay
- No preference
- Don't know
- Other (please specify)

**11) Will you require a payday loan be paid in full before another payday loan/advance is made?**

- Yes

- No
- Don't know

**12) How many outstanding payday loans will you allow at any one time from your credit union?**

\_\_\_\_\_

**13) How many payday loans will you allow a member to take out within a specified period of time (e.g., within a calendar year)? Make sure to identify the timeframe to which you are referring.**

\_\_\_\_\_ per \_\_\_\_\_

**14) Which underwriting and/or qualification criteria will you want to include as part of your payday loan product? (CHECK ALL THAT APPLY.)**

- Minimum length of membership requirement (e.g., 30-, 60-, 90-days)
- Minimum length of employment requirement (e.g., two months)
- Requirement that existing CU loans are not delinquent
- Active (non-negative) checking account requirement
- Minimum credit score requirement
- Direct deposit (of paycheck) requirement
- Post-dated check or ACH pre-authorization requirement
- None of the above -- All applicants should get a loan
- None of the above -- All applicants should get a loan unless they have caused the CU a loss
- None of the above -- All applicants should get a loan unless they are in collections or potential bankruptcy
- Don't know
- Other (please specify)

**15) Which of the following fee options are you most likely to consider for your payday loan product?**

- Annual fee (used in conjunction with a line-of-credit/open-ended loan) + interest
- Flat fee for all loan applications (must be charged to all that apply) + interest
- Flat fee per \$100 loan increments
- Monthly fee for a bundle of CU products/services (including the payday loan)
- Interest only (no fee)
- Don't know
- Other (please specify)

**16) Is your credit union interested in offering your payday loan product in conjunction with relationship pricing? For example, a member might receive a discounted interest rate or fee if they use predetermined credit union services or delivery channels, or if they opt into a savings or educational program feature.**

- Yes
  - With CU Checking Account
  - With Direct deposit or PRD
  - With financial education
  - With a restricted savings account
  - Other \_\_\_\_\_
- No
- Don't know

**17) Do you wish to provide your payday loan product on-site at the credit union office (like a traditional payday loan outlet), or would you prefer to offer a 24/7 online product?**

- On-site at the credit union office only (in-person contact required)
- Online fully-automated product only
- We would like to offer both options
- Don't know

**18) To what extent should a financial education and a savings component be included with the payday loan product?**

	Mandatory	Optional (w/incentives to use)	Do not include	Don't know
Financial education component	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>
Restricted savings account component	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>

**19) Which of the following risk mitigation techniques would you prefer to include with the payday loan product? (CHECK ALL THAT APPLY.)**

- Pooling risk among several credit unions (e.g., Stretch Pay)
- Insuring risk with CUNA Mutual or other insurer
- Increasing the membership longevity requirement until CU gains experience
- Offering the loan with a non-profit partner(s) that can absorb some of the losses
- Limiting outstandings to a specific dollar amount or % of loan portfolio
- Advance-funding a special reserve set aside for product losses
- None of the above
- Don't know
- Other (please specify)

# Appendix B

## APPENDIX B: PAYDAY LOAN MODELS

	StretchPay	Better Choice	Prospera GoodMoney	Freedom Loan A & B	XtraCash	SECU - SALO
<b>Maximum Loan Amt.</b>	\$250 or \$500 LOC	\$500 + 10% savings + app fee; Open or Closed End	Avg. loan is \$400	\$500 LOC	\$500	*\$500 or amt. of paycheck (which ever is less) *Avg is \$374 *open end
<b>Repayment Term</b>	30 days	Up to 90 days; minimum monthly payments required	2 weeks	Up to 90 days	2 weeks to 30 days (depending on state laws). Extended payment Plan available: 4 equal payments due next 4 pay periods at no additional cost	Next pay day
<b>Interest Charges</b>	18% APR	*18% APR max *Some CUs charge less for PRD	\$9.90 per \$100	Freedom A: 25% Freedom B: 27%	*\$9 to \$15 per \$100 (depending on discount & state laws) *Discount if repaid thru CU checking or savings *Discount for fin. ed. *Xtra discount for both	12% APR
<b>Other Fees</b>	\$35 (\$250) or \$70 (\$500) annual fee	\$25 app fee (or less) - can be financed	No	Freedom A: \$25 annual fee; Freedom B: \$40 annual fee	No	No
<b>Rollovers?</b>	No, loan paid in full before another advance	No, loan paid in full before another advance	*Yes *After 3rd rollover, customer is given certificate to counseling center, value of \$50 *50% roll loan over; 38% do so more than 3 times	Yes, at no additional fees	Yes (depending on state laws)	Must be paid in full before next advance
<b>Underwriting Criteria</b>	*18 years of age *60 days CU Member *Verified income *Not be in process of bankruptcy *Not caused loss to participating Cus *Limited credit check (for counseling purposes)	*18 years of age *No credit check for loan approval *Other criteria left to discretion of CU	*Uses sub-prime credit check	*18 years of age *Must have checking account in good standing for 90 days *Freedom A requires direct deposit	*Uses sub-prime credit check	*Requires direct deposit
<b>Financial Ed Required?</b>	No, but strongly encouraged by each CU.	Yes, provided by CU or 3rd party	*No, but with 3rd rollover, given certificate worth \$50 for fin. counseling *If member takes counseling, next loan is fee-free *Have found only a small number take counseling	Optional financial counseling through BALANCE	Optional - member receives discount on rate with fin. ed.	*BALANCE offered at no cost *Tried to make counseling required, but only sent members back to PDLs
<b>Savings Required?</b>	Not required, but some Cus have added a mandatory savings component to their StretchPay program	*10% of loan amount can be added into loan *Cannot be withdrawn until loan paid *Can be added to loan amt. *CU reimburses 18% charge on savings when loan paid	No	Yes, 10% of borrowed amount into savngs until loan paid in full	No	*5% of each advance must be put into savings *If withdrawn, cannot access SALO loan for 6 months
<b>Unique Characteristics</b>	*Must join CUOSI *Members' fees paid to CUOSI for Loan Loss Reserves *Up to 90% of losses reimbursed by CUOSI	*Max loan with fee & savings can be \$575 *50% of loan losses covered by Treasury deposit *CUs agree to report results to League for tracking purposes	*Losses run \$4.36 per \$100 *Operate from a Goodwill Store *Open to everyone; 95% of loans approved *Makes cash loans, rather than checks, so customer doesn't have to go to check casher *Refers people to other social service agencies	Loan does not have to be paid in full to borrow up to maximum limit	*CUSO pays CU for origination *CUSO owns the loans, takes all risks for losses, provides the web-based system, does all the servicing and collections	*Payment info reported to Equifax *70% who use SALO product, do so monthly *Collection efforts include letters, phone calls, and small claims court judgments
<b>Contact Information</b>	Becky Hart, VP, Public Affairs, Ohio CU League <a href="mailto:rhart@ohiocul.org">rhart@ohiocul.org</a>	Diane Powell, Dir of Communications, Pennsylvania CU Assoc., <a href="mailto:Diane.powell@pcua.org">Diane.powell@pcua.org</a>	Ken Eiden, CEO, Prospera CU, <a href="mailto:Ken.eiden@myprospera.com">Ken.eiden@myprospera.com</a>	Penny Peters, St. Louis Community CU, <a href="mailto:Penny.Peters@stlouiscocommunity.com">Penny.Peters@stlouiscocommunity.com</a>	Lon Neofotist, Managing Director, <a href="mailto:lneofotist@xtracashilc.com">lneofotist@xtracashilc.com</a>	Phil Greer, SVP Loan Admin., State Employees CU, <a href="mailto:Phil.Greer@ncsecu.org">Phil.Greer@ncsecu.org</a>

## ***Appendix C***

### **Business Plan Considerations for Payday Loan Product**

(Borrowed from the Montana Credit Unions for Community Development)

#### **Objective:**

To offer an affordable alternative to payday loans to meet the short-term credit needs of our members, in a way that is both empowering for the borrower and sustainable for the credit union, thus furthering our social mission. With the growth in payday lenders in our area, our credit union has decided it is our obligation to develop and market an alternative product to meet the short-term credit needs of members with impaired credit.

The following are considerations to be addressed before the implementation of an alternative payday loan product:

#### **Considerations to meet NCUA planning guidelines for subprime lending programs:**

1. Does this program fit into your strategic lending plan?
2. Is your capital adequate to sustain potential losses?
3. You will need to establish performance objectives. How many loans do you expect to grant? What is the expected default rate? How will delinquencies affect your collection department?
4. Establish a “test” period before offering on a large-scale basis. How many loans will be in the test and for what period of time? An example would be, a maximum of 50 loans and a test period of six months to gauge defaults and delinquencies.
5. How will implementation impact lending staff? You will need to designate staff “experienced” in subprime lending.
6. Establish guidelines to test the portfolio during times of deteriorating economic conditions; i.e., what’s the worst case if the local economy goes bad?

#### **Considerations for policies and procedures:**

1. A board policy should be implemented granting authority to approve these types of loans.
2. Address risk tolerance for your credit union. Consider placing a limit on the portfolio, such as a percentage of the total loan portfolio or a percent of assets, etc.

#### **Considerations for monitoring:**

1. Establish a method of tracking this type of loan and delinquencies.
2. Track performance (loan volume, delinquencies, charge-offs) and report monthly to management and/or board of directors.

3. Review defaulted loans to aid in consideration of underwriting and collection practices.

**Consideration for controls:**

1. Establish a separate line item within allowance for loan losses.

**Considerations for servicing/collections:**

1. Provide training for collection staff on working with subprime borrowers.  
Maintain a contact log for each borrower.  
Provide courtesy contacts a day or two prior to payment date.  
Can you accept payments via direct deposit?
2. If you have a charge-off policy, does it need to be amended to reflect special circumstances surrounding payday loans?
3. Begin collection efforts immediately upon delinquency.

**Sample procedures for payday alternative loan product:**

1. Borrower must be a member of the credit union for \_\_\_ days.
2. Borrower will be required to show proof of identification (current driver's license, etc.). Proof of residency may also be required (utility bill, etc.).
3. The borrower will be required to fill out a simple application form and sign an authorization form.
4. The processing time will be shorter than that of regular loans, so that the borrower can apply and receive the loan in one visit. The credit union may want to establish a "hard close" procedure.
5. Establish credit union underwriting guidelines for loan.
6. Establish credit file documentation requirements. The file requirements could include setting up a contact log sheet which includes references, personal friends and relatives, including phone numbers.
7. Credit union may choose to set up an auditing procedure so that files are reviewed for proper underwriting, documentation, and pricing.
8. Set up quality control procedures to be sure that loans are classified properly so that they can be monitored.
9. Set up procedures in collection department for monitoring credit performance of this portfolio (i.e., payday loans are set up under separate loan type and a delinquency report is produced weekly to be monitored by collections). The procedure could include a report to management at certain intervals during the month on the delinquent status of these loans.
10. Identify how frequently reports will be provided to the board of directors.  
Identify how the credit union will handle accounts when members are delinquent and time frame for charge-offs.
11. Credit union may set up a monthly procedure to review defaulted loans to determine changes to underwriting or a change in collection practices.

12. If the credit union chooses to require members to complete an education session, a monitoring procedure should be set up and tracked.

# A Creditorial

February 2008



## StretchPay Program Saved Ohioans Millions in 2007

### A Proven Alternative to Payday Lending

The credit union alternative to traditional payday lending, StretchPay, saved members of thirty-one credit unions more than \$3 million in 2007. Twenty-seven of the credit unions that offer StretchPay are located in Ohio. Ohio credit unions understand the need for short-term lending exists, and they are providing their members with a consumer friendly, cost-effective solution.



### StretchPay a credit union salary advance alternative

*Paulette Stroba-Davis was feeling the financial pinch and her next paycheck was still days away. Instead of resorting to expensive payday lenders that charge triple-digit loan rates, she turned to Day Air Credit Union in Kettering for a StretchPay loan. The "affordable and reasonable" credit union salary advance alternative helped her family pay a flurry of bills coming due.*

Collectively, credit unions offering StretchPay made 64,400 salary advance loans last year totaling nearly \$25 million. They collected \$476,000 in fees and \$187,000 in interest, at an annual percentage rate (APR) of 18%. If credit union members had borrowed the same amount of money at traditional payday lenders — where consumers are generally charged \$15 per \$100 borrowed and up to 391% APR by payday lenders licensed in Ohio — they would have paid more than \$3.7 million in interest and fees.

StretchPay is a lower-cost alternative for credit union members in need of small cash advances for short terms. A credit union charges an interest rate of 18% APR, along with an annual fee of \$35, for a \$250 StretchPay loan. The entire balance must be repaid by the borrower within 30 days before the member can take a new advance. Some credit unions also offer \$500 StretchPay loans at 18% APR, with an annual fee of \$70.

### Education Is the Key

What further separates StretchPay from traditional payday lending is the financial education component. In addition to the loan, members receive financial education and counseling from their credit union to help them make wise, long-term financial decisions and break free of the payday lending debt treadmill. Credit unions also report loan payments to the credit bureaus, allowing StretchPay members to build upon their credit standing.

Credit union members have already used the financial education offered to help them achieve their dreams and get on a stable fi-

ancial path. A long-time teacher and StretchPay borrower who had never owned a home, worked one-on-one with a financial counselor at her credit union and attended home-buying seminars offered by the credit union. In just 20 months she became a homeowner. Another credit union member who wanted to pay off her credit cards began using StretchPay loans to help offset her debt.

### StretchPay saves credit union members more than \$3 million in 2007.

- 31 credit unions made 64,400 StretchPay loans totaling \$25 million.
- Ohio is home to 27 of the 31 credit unions offering StretchPay loans.
- StretchPay offers loans at an 18% APR.
- Members would have paid \$3.7 million in fees at traditional payday lenders.

She was taught by her credit union how to limit her expenses, create a monthly budget, and is now breaking free of the payday lending cycle of debt thanks to StretchPay and financial education from her credit union.

### Who can join?

Most Ohioans are eligible for membership in at least one credit union. While not all credit unions offer StretchPay, similar short-term lending programs are available at credit unions throughout the state. Credit unions exist to serve their more than 2.6 million members in Ohio and continue to work to find affordable and accessible solutions to member's financial needs.

*For more information about the credit union StretchPay program, please contact the Ohio Credit Union League's John Florian, Vice President of Government Affairs, or John Kozlowski, General Counsel, at 614-336-2894 or 800-486-2917.*

*The purpose of A Creditorial is to inform public officials about financial issues of importance to Ohioans today.*

### Ohio Payday Lending Snapshot

- The average borrower takes out 12.6 loans per year.
- Average amount loaned to payday lending consumers is \$328.
- The average APR offered by traditional lenders is 391%.
- Borrowers pay more than \$318 million in fees annually.

Source: Ohio Coalition for Responsible Lending

**PAY DAY LENDING: A bibliography**  
**Credit Union National Association Information Resource Center**  
**May 2008**

- Anderson, Heather. "Check Cashing Legend Tom Nix Weighs in on New Check Cashing Business That Has Credit Union Component." *Credit Union Times* 18, no. 36 (2007): 18.
- \_\_\_\_\_. "Social Credit Unions Purchase Payday Lenders." *Credit Union Times* 18, no. 51 (2007): 43.
- Anonymous. "Standing in the Gap: Credit Unions Offer Short-Term Loans at Rates That Help Not Hurt." *Washington Informer* 2007, S17.
- Bartlett, Michael. "USA FCU Launches Payday Lending Alternative, Makes Local News." *Credit Union Journal* 11, no. 20 (2007): 10.
- Berry, Kate. "Payday Group Consents to More Fee Disclosures." *American Banker* 2007, 6.
- Carr, Matt. "Banks, CUs to Fill Payday Gap? Maybe." *American Banker* 2007, 1.
- Dernovsek, Darla. "CUs to the Rescue." *Credit Union Magazine* 73, no. 3 (2007): 56.
- Jerving, Jim. "Stretching to Serve; Wright-Patt Seeks to Lure Members Away from Payday Lenders with 'Stretch Pay'." *Credit Union Journal* 11, no. 8 (2007): 22.
- Komar, Charlene. "Get Off the Treadmill." *Credit Union Management* 30, no. 3 (2007): 56.
- Messmore, Scott. "Don't Complain About Check Cashers-Steal Their Business." *Credit Union Journal* 11, no. 22 (2007): 4.
- \_\_\_\_\_. "Predator or Savior?; Why CUs Should Be Payday Lenders." *Credit Union Journal* 11, no. 10 (2007): 1.
- Moed, Joyce. "Air Academy FCU Has a 'Smart Solution' to Keep Members from Payday Lenders." *Credit Union Journal* 11, no. 27 (2007): 3.
- Morrison, David. "Battle against Payday Lending Appears to Tilt toward Opponents; Former Payday Employees Substantiate Critics Charges." *Credit Union Times* 18, no. 39 (2007): 4.
- \_\_\_\_\_. "CRL, Payday Lenders Bicker over Another Study." *Credit Union Times* 18, no. 51 (2007): 16.

\_\_\_\_\_. "Payday Lenders Roll out More Disclosures Aimed to Both Forestall Regulation and Strengthen Marketing." *Credit Union Times* 18, no. 48 (2007): 1.

Ortiz, Lauralee. "CUs Seek to Beat Payday Lenders at Their Own Game: Pennsylvania CUs Offer 'Better Choice' as Alternative to Payday Loans." *Credit Union Journal* 11, no. 12 (2007): 16.

"Payday Loans: The Color of Money." *Credit Union Journal* 11, no. 47 (2007): 24.

Rapport, Marc. "Sarasota Coastal, Galaxy Team up to Launch Automated CU Alternative to Payday Lenders." *Credit Union Times* 18, no. 46 (2007): 22.

Rubenstein, Jim. "South Carolina Credit Union Scores Big on Payday Product." *Credit Union Times* 18, no. 28 (2007): 3.

\_\_\_\_\_. "Wal-Mart Prompts New Credit Union "Unbanked" Moves." *Credit Union Times* 18, no. 29 (2007): 1.

Samaad, Michelle A. "Understanding The "Misunderstood" Payday Loan User May Help Credit Unions with Alternatives." *Credit Union Times* 18, no. 19 (2007): 1.

\_\_\_\_\_. "Veridian CU Gets Jump on Iowa Bill to Cap Car Title Loans with New Payday Loan, Savings Combo Alternative." *Credit Union Times* 18, no. 6 (2007): 6.

Tescher, Jennifer. "Viewpoint: Product Innovation: A Balanced Approach." *American Banker* 2008, 11.

Wolff, Mark. "CU Modest-Means Efforts in the Spotlight." *Credit Union Magazine* 72, no. 11 (2006): 26.

Many of the articles on this bibliography are available from the IRC. To order, please call 1-800-356-9655 ext. 4308.



The Credit Union National Association, Inc. (“CUNA”), through its Council, and Real Solutions/National Credit Union Foundation offers the information and policies within this white paper for information only. The enclosed information should not be considered legal advice and should not be relied upon or substituted for the same. The Council and Real Solutions/National Credit Union Foundation do not provide legal, accounting, or other professional advice, and materials should be reviewed with a competent professional prior to use. The Council and Real Solutions/National Credit Union Foundation provide no warranties, expressed or implied, regarding the materials published therein. Reference herein to any specific vendor, commercial product, process or service does not constitute or imply endorsement, recommendation or favoring by CUNA or Real Solutions/National Credit Union Foundation.

The views and opinions of the author(s) do not necessarily state or reflect those of CUNA or Real Solutions/National Credit Union Foundation and shall not be used for advertising or product endorsement purposes, unless a formal endorsement relationship exists with the third party vendor. If you question whether a product or service is formally endorsed by CUNA or Real Solutions/National Credit Union Foundation you may contact [cunawebmaster@cuna.org](mailto:cunawebmaster@cuna.org).

© 2008 CUNA, Inc. All rights reserved. Reproduction is prohibited without written consent.