Small Dollar Loan Profitability Calculator FAQ

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Q) My Cost of Funds is zero, but the calculator does not like that, should I use 0.001 or does your Cost of Funds mean something different than ours?

A) "Cost of funds" is what financial institutions pay for the money that they lend to customers. Usually these funds come from deposits, and sometimes they are borrowed from other institutions or the government. Even when interest rates are very low, there will be some cost to these funds. The cost usually takes the form of interest paid on deposits or on loans from other institutions. In the highly unlikely (if not impossible) event that cost of funds is 0, the best strategy is to enter 0.001.

Q) To better understand our Personnel Expenses, what is a reasonable decline rate for borrowers, in other words, how many apply and how many are declined?

A) This is entirely dependent upon your bank's underwriting standards. More lenient standards will result in more applicants and fewer rejections, but higher delinquency and loan losses. Stricter standards will result in fewer applicants and more rejections, but lower delinquency and loan losses.

Q) Are there special collection strategies that can be used with SDL's to keep losses low?

A) Because of the small size of SDL loans and the relatively high expense of personnel time, the lowest cost collection strategy may simply be to make little effort to collect. Alternatively, outsourcing collection efforts to a commission-based firm will eliminate the institution's collection costs. However, since collection firms may create an unpleasant borrowing experience, this strategy poses the risk of alienating customers.

Q) What do you use to determine the ability to repay?

A) It varies by financial institutions. The following are some types of documents used by a bank or credit union: proof of employment, recent pay stubs, average balance at a deposit account open for more than one year, previous year's W-2's, and titles to assets are all solid indicators of ability to repay.

Q) What rate is reasonable to charge? Is it tiered based on amount borrowed or a flat rate?

A) Generally speaking, a reasonable rate is one that a borrower can afford and yet is expected to earn a profit for the lender. When paired with the term and fees, a financially safe rate for the borrower should yield an APR below 36%.

Q) Will the SDL breakeven, be profitable (how much), or a loss leader when you take into account all the expenses to support the program?

A) Whether the SDL will break even, be profitable, or be a loss depends upon the scale of the program. An SDL product offered as a complement to an existing loan product line-up will be low-cost, serve as value-add to existing customers, and potentially attract new ones. A scaled up program will consume additional resources, displace potential income from other loan products, and thus have greater potential for income and loss. The SDL profitability calculator is designed to help answer this question in greater detail by allowing users to input cost factors specific to their bank or credit union.

Q) Are there safeguards built into this calculator to ensure that these loans will not be predatory?

A) Yes. If an effective APR turns out to be higher than 36%, then a warning message will pop up indicating that the loan is unsafe for borrowers. A warning will also appear if a term is 3 months or shorter, a term timeframe borrowers often find difficult to repay without taking out additional loans.

Q) Is it reasonable for the rate to be fixed or variable?

A) Given that the term of SDLs is generally short, a simple and straightforward fixed rate makes the most sense. Furthermore, the calculator is equipped to calculate a fixed rate only.

Q) My bank has never offered an SDL before, what Delinquency Incidence Rate can we reasonably expect?

A) SDL's delinquency rates are typically a bit higher than other unsecured credit. To get an idea of these rates, you can look at your own institution's financial statements. Alternatively, the Federal Reserve publishes national statistics on loan performance at: http://www.federalreserve.gov/econresdata/

Q) Does the underwriting criteria differ for a SDL versus traditional lending products? If so, can we expect SDL underwriting Personnel Expenses to be higher or lower per loan than a traditional lending product?

A) An essential element of approving any safe SDL is determining a borrower's ability to repay. The underwriting criteria for SDL's can be less in-depth than with a traditional loan product as the borrowing amount is lower. As a result, institutions can expect to incur lower personnel expenses.

Q) Is there any economy of scale benefits we can expect to see in lower underwriting Personnel Expenses if we issue a lot of SDLs per year?

A) Scaling up an SDL program may reduce underwriting costs through better rates from loan servicing providers. However, be mindful that a larger SDL program will also consume a greater proportion of the institution's fixed expenses.

Q) If I want to make sure to obtain a profit while still keeping the loan safe, is it safer to increase the Origination Fee or the Interest Rate depending on whether we setup a shorter or longer term?

A: The effective APR calculation is the best tool to assess the safety of a loan because it accounts for both fees and interest rate. In general, a longer term will result in a lower APR and will be easier for a borrower to repay. However, a longer term also increases the likelihood of a loan becoming delinquent. Fees may prove to be a greater source of revenue than interest, but fees also drive up the effective APR--especially with shorter terms. The calculator was designed for institutions to discover their own particular “sweet spot” of term length, fees, and interest rate to make a sustainable and safe SDL customized to their institution.

Q) How do I calculate the Fixed Expenses Per Loan for my institution?

A) Fixed expenses per loan is a straightforward calculation. Fixed expenses are expenses that are relatively stable. They include, for example, utilities, leases, insurance, and other non-interest, non-personnel operating expenses.

To calculate Fixed Expenses Per Loan:

- You can find your financial institution's fixed expenses on the income statement, usually under sub-heading of "Non-interest expense."
- Sum up these fixed expenses.
- Next, you'll need to calculate the SDL portfolio as a percentage of total assets. "Total assets" reflects the total value of loans outstanding and is a line item on the financial institution's balance sheet. Divide the SDL portfolio's total value by total assets.
- Multiply this percentage by the total fixed expenses. Finally, divide this number by the number SDL loans outstanding. This figure is "fixed expenses per loan."

Q) Are Delinquency Rate and Late Fees connected in the calculator? We consider abandoned loans as Delinquent, not ones where payments are not timely made, but still made.

A) Because financial institutions have different ways of assessing late fees, the calculator does not tie late fees to delinquency rate. It defines delinquency rate as abandoned loans.

Q) If I will be partnering with employers for SDL payments through payroll deduction, is it reasonable to make my Late Fee and Delinquency Incidence Rates zero?

A) Automatically withdrawing loan payments via payroll deduction is a way to significantly reduce late fees and delinquency, but it does not eliminate the potential for either entirely.