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Small Dollar Loan Toolkit

A Guide to Creating a Profitable and Consumer Friendly Product

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Report Information

This report is published by Heartland Alliance for Human Needs & Human Rights for The Illinois Asset Building Group (IABG). IABG is a diverse statewide coalition invested in building the stability and strength of Illinois communities through increased asset ownership and asset protection. We believe that every person deserves the opportunity to save and build wealth across their life-time. Through our advocacy efforts, we are committed to addressing the growing racial wealth gap and creating safe opportunities for Illinois families to save for their future and the future of their children.

Our work across issue areas includes examining barriers and solutions to the persistent racial wealth gap. We focus our efforts on policy development, coalition building, stakeholder engagement, education of policymakers and advocacy to provide equitable opportunities for asset building. IABG is co-chaired by Heartland Alliance for Human Needs and Human Rights and the Sargent Shriver National Center on Poverty Law. Our partners include community leaders, service providers, researchers, advocates, and financial institutions.

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Executive Summary

> **Online SDL Profitability Calculator**
> IABG's online SDL Profitability Calculator can help banks and credit unions evaluate the profitability of a loan product

This toolkit serves as a resource for banks and credit unions interested in offering a safe, profitable, small dollar loan product. The information provided was informed by analyzing the structure of existing loan products, reviewing existing programs and research, and conducting focus groups with small dollar loan borrowers. It provides a coherent summary of the Small Dollar Loan (SDL) environment and the resources necessary to create a safe small dollar loan. An alternative to payday loans, SDLs are a means for customers to obtain necessary credit to pay bills and bridge financial gaps between paychecks. In this toolkit we will define Payday and Small Dollar Loans, outline the advantages of SDLs for customers and financial institutions alike, and review important aspects to consider for credit unions and community banks interested in providing SDLs to new and current customers. The toolkit also provides an online, interactive, profitability calculator to help financial institutions create a consumer friendly, profitable, loan.

Payday Loans in America

In 2010, the payday loan market reached $7.4 billion in lending activity preying on low income and unbanked Americans.[1] According to a 2012 survey of small-dollar borrowers by the Pew Charitable Trusts' Safe Small-Dollar Loans Research Project, 5.5% of adults nationwide have used a payday loan in the past five years and within the last year alone 1.7% of U.S. households, including 9.5% of unbanked/underbanked households, have used payday lending.[1] In Illinois alone over 1.2 million payday loans were issued between 2006 and 2008.[2]

Each year, over 12 million Americans become trapped in a cycle of debt thanks to predatory payday loan products.[1] While initially appearing to be a good value, customers are met with hidden fees and high interest rates that often increase loan costs over the actual loan amount. Payday loans have high fees ranging from $15-$30 for every $10 borrowed which translates to an annual percentage rate (APR) in the triple digits, nearly 400% with a term of 10 days. So for example, while the average payday loan is for $375, the borrower ends up repaying $520 when interest and fees are added. Thus, most payday borrowers end up in a cycle of debt – taking out more payday loans to repay their previous loans. The average number of loans taken out per payday loan borrower per year is high at an average of eight loans per person in 2010.

Individuals enter into such short term, high interest loans due to their insufficient credit, lack of easy access to a mainstream financial institutions and the need for money to make ends meet. Although some financial

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[1] Safe Small Dollar Loans Research Project. (July 2012). Payday Lending in America: Who Borrows, Where They Borrow, and Why. Pew Charitable Trust. Retrieved from http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Reports/Safe_Small_Dollar_Loans/LOANS_Payday%20Lending%20Report%20Final_web.pdf on September 25, 2012.

[2] Illinois Department of Financial and Professional Regulation. "Illinois Payday Loan Reform Act: Three Year Report." March 2009, http://www.idfpr.com/dfi/CCD/3YearPLRAReportDFI.pdf

institutions offer small dollar products, most consumers are quick to turn to predatory products such as payday loans because of their convenience and availability. Payday lenders tend to operate longer hours, issue loans quickly, and are often heavily concentrated low-income communities. As a result of this high demand the payday loan industry has grown dramatically from just 500 locations in 1990 to over 22,000 in 2010.[3]

The widespread growth of payday lending confirms a strong demand for small-dollar loans, which could be translated into a safer more affordable SDLs offered by financial institutions. As an alternative to the payday loan system, the relatively low fees and APRs of SDLs through credit unions and banks make it easier to pay off the loan in full rather than renewing the loan or taking out additional loans. Many small dollar loans also include a cooling off period which prohibits extending additional loans for a certain period of time after the first loan thereby eliminating the threat of a consumer getting caught in a cycle of debt.[4] SDLs typically cap APRs at 36% and, unlike their predatory counterparts, payday loans, have low fees. These practices increase the long term financial stability of individuals as well as communities. Savings from lower borrowing costs spur spending at local stores and shops, greater personal financial stability, and less reliance on government subsistence programs.

Payday Lenders are Everywhere

By 2004 check-cashing and payday-lending outlets in America outnumbered all the McDonand's, Burger Kings, Target, Sears, JCPenneys, and Wal-Mart combined (33,000 versus less than 29,000, respectively).[5] In 2005, there were also more check cashing and payday lenders than Starbucks.[6]

Payday Loans in Illinois

The Illinois Consumer Installment Loan Act, which passed in 2011, offers consumers certain protections against payday lenders. The law has curtailed "churning" by prohibiting lenders from rolling a loan over into a new loan within 75 days after the end of the original loan's term. It is also against the law for lenders to issue a new payday loan if doing so would indebt a borrower for more than 45 days in a row.

The law also requires that loans be based on a borrower's ability to pay. Specifically, it maxes out a payday installment loan's monthly payments at no more than 22.5% of a customer's gross monthly income. Yet, even with these reforms, payday loans in Illinois remain expensive and predatory. While there are a number of different types of payday loans in Illinois, the APR can legally run as from a minimum of 99% to as high as 400%. Illinois consumers who can't pay off a payday loan that is more than 35 days past due, are entitled to enter into an interest-free repayment plan. These provisions are intended to stop the cycle of debt by giving borrowers time to pay off their old payday loan debt without getting hit with additional charges and fees.

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[3] Gogoi, P. (2010, March). Costly Cash: The Great Recession is Paying Off for Pawnshops and Payday Lenders. *Daily Finance*. Retrieved from http://www.dailyfinance.com/2010/03/09/costly-cash-the-great-recession-is-paying-off-for-pawnshops-and/ on October 4, 2012.

[4] CRL Policy Brief. (2010, February). Mainstream banks making payday loans: Regulators must put swift end to new trend. *Center for Responsible Lending*. Retrieved from http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/mainstream-banks-making-payday-loans.pdf on October 5, 2012.

[5] Graves, S.M. (2006). McDonalds' vs. Payday Lenders. *California State University Northridge.* Retrieved from http://www.csun.edu/~sg4002/research/research_home.html on October 4, 2012.

[6] Stegman, M.A. (2007). Payday Lending. *Journal of Economic Perspectives,* 21(1): 169-190.

A payday loan is a high-cost, short-term cash loan that frequently becomes a debt trap for borrowers. Most payday loans carry triple-digit interest rates and have hidden fees. Borrowers access these loans in stores, some banks, or through the Internet. An average payday loan is made for eighteen days for an average amount of $375, and a borrower typically pays around $520 in fees and interest for such a loan.[1]

Most payday loans work like this:

- In exchange for a post-dated personal check from the borrower or authorization to automatically debit the borrower's checking account, a consumer receives cash.
- Underwriting and loan approval is based on information from a borrower's pay stub. Lenders rarely make an attempt to determine if a borrower can afford to repay the loan. Nor do they conduct a full credit check or establish the borrower's debt-to-income ratio.
- The lender holds the check until the borrower's next payday, at which point, the borrower must repay the loan amount plus finance charges in a lump sum.
- To pay the loan in full, borrowers can redeem their check for cash or simply allow the check to be deposited by the lender.
- Borrowers who can't pay the entire loan amount often opt to roll over the loan for another period, thus incurring new finance and interest charges.

Even if borrowers can repay their loan when it is due, they may be left without adequate funds to cover other expenses and are therefore forced to take out another payday loan immediately or shortly thereafter. In fact, a full three quarters of loan volume of the payday lending industry is generated by borrowers who, after meeting the short-term due date of the loan, must re-borrow before their next pay period.[7]

The Market for Safe Small Dollar Loans

What Are Safe Small Dollar Loans?

Small dollar loans (SDLs) are loans for a relatively small amount of money, usually up to $2,500, issued by banks and credit unions. Since there are a variety of small dollar loans, it is important to distinguish between small dollar loans that are safe for consumers and those that are harmful.

Safe small dollar loans share the following features:[8,9]

- An APR, including fees, of 36% or less
- A term of at least 90 days, or one month per $100 borrowed
- Multiple installment payments with no balloon payment at the end
- The ability of the borrower to repay the loan is considered by the lender

Other features which are sometimes included in SDLs are savings components by placing a portion of the loan principal into a savings account and/or requiring participation in financial education or credit counseling.

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[7] Parrish, L., King, U. (2009, July). Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume. *Center for Responsible Lending.* Retrieved from *http*://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf on October 4, 2012.

[8] Federal Deposit Insurance Corporation. (2010). A Template for Success: The FDIC's Small-Dollar Loan Pilot Program. *FDIC Quarterly, 4(2), 28-42.* Retrieved from http://www.fdic.gov/bank/analytical/quarterly/2010_vol4_2/FDIC_Quarterly_Vol4No2_SmallDollar.pdf on October 4, 2012

[9] Plunkett, L.A., Saunders, L.,. (2010, December 1). Put Your Money Where the Shark's Mouth Isn't: Loan Options for Mississippi Borrowers That Are Better Than Payday Loans. *National Consumer Law Center*. Retrieved from http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/rpt-loan-options-ms.pdf on September 26, 2012.

Who Offers Small Dollar Loans?

With an increase in public awareness of the dangers of payday loans and a market demand for safe alternative loan products, an increasing number of institutions now offer SDLs.

Credit Unions:

Credit unions are member-owned nonprofit financial institutions that prioritize serving member-customers over maximizing profits.[10] Credit unions serve a specific membership and potential members must be part of a field of membership, which is typically based on one's employment, community, or membership in an association or organization. On the whole, credit unions typically offer higher savings rates, lower fees, and lower rates on loans with most capping their interest rates at 28% APR for SDLs below $1,000.[11]

Banks:

A number of banks offer SDL products. More than 37% of small financial institutions -- banks and credit unions with less than $100 million in assets -- already offer some kind of SDL program.[12] Moreover, of those not currently offering SDLs, 23% plan to do so within the next year.[13] Bank SDL products typically have a longer loan term than a typical payday loan 2-week cycle. This avoids the need to immediate repay the loan and provides borrowers with more time to recover from the financial emergency payment that required them to borrow in the first place. The interest rates and fees that bank charges are also less than those charged by payday lenders, though not as low as credit unions.

What are the Financial Benefits of Small Dollar Loans?

Mainstream financial institutions can benefit from offering safe small dollar lending by serving as the arbiter of sound financial practices for low- and moderate-income clients and profiting in a responsible way from current demand for such a product. Small dollar loans are a growing part of many traditional lenders' portfolios. Institutions looking to attract and retain loyal customers, cross-sell additional products, and/or promote a positive community image will want to consider small dollar loans.

Although there is not enough data to measure the profitability of these products yet, many banks see these loan products as the cornerstone of longer-term relationships and goodwill with customers in their community. Some banks transitioned customers into more sophisticated products. One participating bank found that auto loans were a "next step" in building the lending relations with small-dollar loan customers who successfully pay off their loan.

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[10] National Credit Union Administration. About Credit Unions. Retrieved from http://www.mycreditunion.gov/about-credit-unions/Pages/default.aspx on October 5, 2012.
[11] National Credit Union Administration. (2010, October). Final Rule – Part 701, Short-term, Small Amount Loans. [Regulatory Alert]. 10-RA-13. Retrieved from http://www.ncua.gov/Legal/Documents/Regulatory%20Alerts/RA2010-13.pdf on October 5, 2012.
[12] New, C. (2012, June). Payday Lending to be Offered at More Small Banks, Credit Unions, Survey Finds. *Huffingtonpost*. Retrieved from http://www.huffingtonpost.com/2012/06/26/payday-lending-small-banks-credit-unions_n_1627795.html on October 4, 2012.
[13] Rate Watch. Small Dollar Loans-The Financial Institution Response to "Payday Lending". Retrieved from http://big.assets.huffingtonpost.com/paydaylending.pdf on October 4, 2012.

Cross-Sell Additional Products to Existing Customers

One significant opportunity for financial institutions to generate additional revenue from safe small dollar loan borrowers is to cross-sell them other suitable products and services. Some of the banks participating in the FDIC's Small Dollar Loan Pilot program reported that customers graduated to other bank services after using a small dollar loan product.[14] As the FDIC notes, "over time, [alternative small dollar loan] borrowers should be able to improve their credit histories and graduate to other more significant asset-building loans, such as home mortgage loans and small business loans. We encourage institutions to make borrowers aware that they offer such products."[15]

Fast Facts

- 34 million U.S. households (68 million individuals) are either unbanked or underbanked.[16]
- 1.7% of unbanked households and 7.9% of underbanked households have used payday loans in the last year.[16]
- In Illinois, 7.6% of all households (an estimated 374,000 households) are unbanked and 17.7% of all households (an estimated 879,000 households) are underbanked.[16]

Additionally, since a checking account is almost always a prerequisite to receive a payday loan, payday loan consumers already have accounts with mainstream financial institutions. But rather than obtain a loan from their financial institution they take their loan business elsewhere, primarily because their financial institution does not offer these products. About 20% of checks used as collateral for payday lenders are written on credit union checking accounts, according to credit union experts.[17] Banks and credit unions that do not offer SDLs are practically throwing away business to their nonfinancial institution competitors. By offering SDLs financial institutions can expand their loan activity without having to bring in new customers.

The more products a customer has with a financial institution, the more likely the financial institution is to retain that customer.[18] Thus, over the past several years, increasing cross-selling opportunities has been the number one initiative for bank executives. According to a study released in July 2009, eight out of ten financial institution respondents ranked cross-selling as their number one initiative.[19] Cross-selling products and services helps put the financial institution on more stable and profitable financial footing for the long-term and an alternative small dollar loan product can provide a gateway to cross-sell to the customer.

[14] Burhouse, S., Miller, R., and Sampson, A.G. (2008). An Introduction to the FDIC Small Dollar Loan Pilot Program. *FDIC Quarterly, 2*(3), 2008.

[15] Federal Deposit Insurance Corporation. (2007). Affordable Small-Dollar Loan Guidelines. [Press Release]. Retrieved from http://www.fdic.gov/news/news/press/2007/pr07052a.html on March 28, 2013.

[16] Federal Deposit Insurance Corporation. (2012, September). 2011 FDIC National Survey of Unbanked and Underbanked Households. Retrieved from http://www.fdic.gov/householdsurvey/2012_unbankedreport.pdf on October 4, 2012.

[17] Pierce, N. (2008, May). Payday Lending: The Credit Union Way. *CUNA Lending Council and National Credit Union Foundation / Real Solutions*. Retrieved from http://realsolutions.coop/assets/2008/7/23/NancyPierceCUNALendingCouncilPaydayLendingWhitePaperWithNCUFAndREALSolutions.pdf on September 27, 2012.

[18] Owen, L. (2009, July 24). What is the True Meaning of Cross sales? *Truebridge Financial Marketing*. Retrieved from http://www.truebridge.com/blog/bid/20015/What-is-the-true-meaing-of-Cross-Sales on September 27, 2012.

[19] Grant Thornton LLP. (2009). The Sixteenth Bank Executive Survey. *Bank Director Magazine.* Retrieved from http://www.nubank.com/stories/200905_GrantThorton/GrantThorton16.pdf on September 27,2012.

Attract New Customers

While cross-selling can provide stable revenue and financial footing in an industry experiencing tremendous competition for customers, to grow financial institutions will eventually need new clients as well. The FDIC estimates that over 17 million adults, or 8.2% of households are unbanked.[17] Most unbanked adults have steady jobs and a moderate income.[21] Since a prerequisite for a payday loan is a checking account, there is a large unbanked customer base that would likely be interested in a SDL program. Financial institutions offering such loans could tap into this market and develop valued customers.

By 2004 check-cashing and payday-lending outlets in America outnumber all the McDonald's, Burger Kings, Targets, Sears, JCPenneys, and Wal-Marts stores combined (33,000 versus less than 29,000, respectively).[22] In 2005, there were also more check cashing and payday lenders than Starbucks.[23]

Leverage Advantage in the Market

Banks and credit unions have two inherent advantages over the payday loan industry in successfully offering small dollar loan programs – infrastructure and relationships.

Banks' and credit unions' existing infrastructure minimizes operational costs. While payday loan stores must spend capital on space, staff, advertising and more, financial institutions with established staffing, functioning collection processes, and infrastructure will find they can offer a SDL program without considerable overhead cost, making them more competitive.[24] Banks and credit unions can easily advertise through bank statements and existing marketing materials, further increasing their competiveness.

Safe Small Dollar Loan Borrower:
"Here, you feel comfortable getting a loan and the interest rate is not through the roof. You're not worried about anybody calling your job or calling your friends to say that your payment is due." – M-1 Focus Group participant from an Illinois Credit Union

Banks and credit unions also have the advantage of having an existing relationship with a borrower. An 18 month evaluation by the Woodstock Institute of a National Federation of Community Development Credit Unions pilot of SDL programs in six sites found that borrowers who belonged to a financial institution for one year or more reported much lower delinquency rates on their SDL.[25] A previous relationship with a borrower works both ways as banks can help borrowers determine their ideal SDL as well as ask borrowers to establish direct debt/ automatic deduction from their accounts.

[21] Fellowes, M. (2008, May 15). Bank On: The Market Opportunity. FDIC Alliance for Economic Inclusion Forum in Rochester, New York. *The Pew Charitable Trusts.* Retrieved from http://www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Speeches/080515%20Bank%20on%20Rochester.pdf on September 27, 2012.

[22] Graves, S.M. (2006). McDonalds' vs. Payday Lenders. *California State University Northridge.* Retrieved from http://www.csun.edu/~sg4002/research/research_home.html on October 4, 2012.

[23] Stegman, M.A. (2007). Payday Lending. *Journal of Economic Perspectives,* 21(1): 169-190

[24] Illinois Asset Building Group. (2009, November). Alternative Small Dollar Loans in Illinois: Creating sound financial products through regulation and innovation. Retrieved from http://www.illinoisassetbuilding.org/content/alternative-small-dollar-loans-illinois on October 5, 2012.

[25] Williams, M. (2007, May). Cooperative Credit: How Community Development Credit Unions are Meeting the Need for Affordable, Short-Term Credit. *Woodstock Institute*. Retrieved http://www.woodstockinst.org/publications/download/cooperative-credit%3a--how-community-development-credit-unions-are-meeting-the-need-for-affordable,-short-term-credit/ on September 25, 2012.

What are the Non-Financial Benefits of Small Dollar Loans?

Improve Public Image

Development of an alternative small dollar loan program can help financial institutions improve their image among consumers and the public. From articles in newspapers to television reports, current public perception of mainstream financial institutions—particularly large banks—is negative.[26,27,28] Events and practices like overdraft fees, mortgage foreclosures, and the financial crisis have sullied the public image of the banking industry. Safe SDL products can help assuage the negative public perception of banks.

Safe Small Dollar Loan Borrower
"When I walk in there I'm not another face, I am part of the community, that bank is in my community too, so we have established that kind of rapport."
–Small Dollar Loan Borrower from an Illinois Credit Union

Community Benefits

A financial institution that offers SDLs is not only providing an affordable line of credit to individuals and families, but they are offering a service to their community. Communities benefit from these products because their residents' financial needs are met within the community. A prosperous community will attract more residents and more residents will attract more businesses and so on.

CRA Credit

The Community Reinvestment Act (CRA) was enacted in the 1970s to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods.[29] The CRA requires that each insured depository institution's record in helping meet the credit needs of its entire community be evaluated periodically. This record is also taken into account when considering an institution's application for deposit facilities, including mergers and acquisitions. Federal banking agencies that conduct CRA evaluations have stated that SDLs meet an important credit need of underserved communities and low and moderate-income borrowers.[15] Such a loan product allows borrowers to avoid entrapping, high cost credit, and serves the purpose and mission of the CRA. Thus, by offering these types of loans or supporting the development of SDL pilot projects, banks can earn a positive CRA rating.

[26] Tse, T. M. (2009, October 20). At Rescued Banks, Perks Keep Rolling. *The Washington Post*. Retrieved from http://www.washingtonpost.com/wp-dyn/content/article/2009/10/19/AR2009101903546.html?hpid=topnews on September 25, 2012.
[27] Editorial. (2009, October 4). Where's the money?. *The Philadelphia Inquirer.* Retrieved from http://www.philly.com/inquirer/currents/20091004_Editorial__Where_s_the_money_.html on September 7, 2012.
[28] CBSNews. (2009, April 30). Poll: Frustration Growing Over Bailouts. *CBSNews Online*. Retrieved from http://www.cbsnews.com/stories/2009/03/16/opinion/polls/main4870196.shtml on September 25, 2012.
[29] Such a loan product allows borrowers to avoid entrapping, high cost credit, and serves the purpose and mission of the CRA.

Pilot Programs In Action

FDIC Small Dollar Loan Pilot

The Federal Deposit Insurance Corporation (FDIC) began a pilot program in 2008 with 31 banks in order to illustrate how banks can profitably offer affordable SDLs as an alternative to high-cost, short-term credit products, such as payday loans.[14] The pilot, which lasted 2 years, showed that only a small percentage of participating banks reported that profitability was their primary goal in SDL products. Instead, the majority of participating banks indicated that long-term customer relationship-building and community goodwill was their goal. Positive CRA credit was another consideration that banks cited for offering SDLs.

Under the pilot banks were required to follow certain guidelines in designing their SDL products. Specifically, the following criteria had to be met:

- Loan amounts up to $2,500
- Payment periods beyond of at least 90 days
- Annual percentage rates (APRs) below 36%
- Low or no origination fees
- Streamlined underwriting
- Prompt loan application processing
- Automatic savings component
- Access to financial education

Additionally, ten banks required SDL customers to open a savings account linked to their SDLs, while nine banks encouraged, but did not require, customers to open a savings account.

At the end of the two-year pilot, 18,100 SDLs with a principal balance of $12.4 million were made.[8] More importantly, overall, small-dollar loan default rates were in line with default rates for similar types of unsecured loans. The delinquency ratio for SDLs climbed to 11% in fourth quarter 2009, due primarily to adverse economic conditions, from a relatively stable rate of about 9% for much of 2009. A key lesson learned from the pilot was that most participating banks used SDL products as a cornerstone for building or retaining long-term banking relationships. Almost all of the banks indicated that SDL were a useful business strategy and that they intended to continue their small-dollar loan programs beyond the pilot. Thus, the study showed that banks can successfully offer affordable alternatives to predatory lines of credit such as payday loans while earning CRA credit, goodwill with the community and building up a long-term customer base.

Keys to Success

Banks and Credit Unions across the country, having tested SDLs with customers, graduated SDLs into institution mainstays as a proven product. Many successful programs share the same following characteristics:[8]

- **Support from the Top:** Enthusiastic board and upper management support is critical for successful implementation and promotion of SDL programs.

- **Targeted Location:** SDL programs are most successful when they are focused on branch offices in communities with large populations of low- and moderate-income, military, or immigrant households who tend to benefit from greater demand for such products. Banks in rural markets with few nonbank alternative financial services providers also benefitted from limited competition for SDLs.

- **Staff-Originated Marketing:** In order to minimize traditional marketing and employee training expense, banks focus staff training on those employees with enthusiasm for serving customers who may have limited banking experience.

- **Partnerships with Nonprofits:** Financial institutions, particularly those in suburban locations with less demand at the branch level, benefited from strong partnerships with nonprofit community groups who can refer, and sometimes qualify, potential borrowers.

- **Frozen Savings.** By requiring a fixed amount frozen in a deposit account, creditors can minimize losses, and also provide a positive savings experience for customers.

- **Solid, Streamlined Underwriting and Longer Loan Terms:** Successful banks had certain basic elements to minimizing defaults. Notably, most pilot banks required a credit report to help determine loan amounts and repayment ability, however, few banks used credit scoring in the underwriting process. This information allowed banks to access risk, but was also done efficiently to provide fast approvals which is one of the features that borrowers like about payday loans. Successful banks also had longer loan terms which were critical to loan performance because it gave consumers more time to recover from a financial emergency than a single pay cycle for payday loans, or the immediate repayment often required for fee-based overdrafts. For the pilot overall, a 90-day loan term emerged as the minimum time needed to repay a small-dollar loan.

- **Financial Education:** Financial education benefits customers and likely improves loan repayment, however, successful banks found that requiring financial education as a prerequisite for loan approval impeded borrowers' access to what are often urgently needed funds.

How to Make it Work: Profitability Calculator

Whether you're considering a hypothetical small dollar program or have already launched one, this profitability calculator can help analyze the profitability of an SDL customized to your financial institution. Click the box to the right to access the calculator or visit: http://www.illinoisassetbuilding.org/content/loan-calculator

Online SDL Profitability Calculator
Jump ahead to explore IABG's tool that can help banks and credit unions evaluate the profitability of a loan product

Key Components of a Profitability Analysis

This calculator uses the following key revenues and expenses that affect profitability:

- **Average Loan Amount:** The average principal balance of a single loan.
- **Average Loan Outstanding:** Average outstanding balance of single loan, using amortization formula.
- **Total Number of loans:** The total number of loans for the analysis period.
- **Portfolio Balance:** Principal balance of loans originating during the analysis period.
- **Actual Losses:** The value of the total unpaid balance charged off.
- **Term (months):** The average term in months of loans of that type originating during the period.
- **Interest Rate**: Annual Percentage Rate charged, not reflective of origination or late fees.
- **Cost of Funds:** Interest rate paid for the use of funds (e.g. deposits,) lent to borrowers.
- **Actual Losses per Loan:** Actual losses divided by the total number of loans originating during the period.
- **Delinquency Incident Rate:** Frequency with which loan repayment was delinquent for loans of that type.
- **Late Fee:** Fee charged for the late payment on a loan.
- **Personnel Cost Per Loan:** A function of personnel cost per hour (salary, benefits, training) multiplied by the number of personnel hours spent per loan, multiplied by the number of loans. For the PAL, first-borrower must conduct a one-on-one counseling session, and that time explains the significant personnel cost per loan.
- **Servicing Cost Per Loan:** A pro rata share of the loan servicing expense for the entire loan period.
- **Fixed Expenses Per Loan:** Fixed expenses include the sum of operating expenses and occupation expenses, derived from the audited call report. Fixed expenses for the loan type’s portfolio reflects total dollar value of the portfolio as a percentage of the institution's total average assets for the analysis period. Fixed expenses per loan is the quotient of fixed expenses per loan divided by the number of loans.
- **Origination Fee:** Fee charged for the origination of the loan.

Additional Resources

Regulatory Information Sources

Federal

Federal Deposit Insurance Corporation: http://www.fdic.gov

National Credit Union Administration: http://www.ncua.gov

Illinois

Illinois Department of Financial & Professional Regulation

Banking: http://www.idfpr.com/dfi/cud/cud_chartering.asp

Credit Unions: http://www.idfpr.com/Bankingdefault.asp

List of Programs and Organizations

Illinois State Treasurer's Micro Loan Program

The State Treasurer's Micro-Loan program provides affordable capital to credit unions and community banks so they can issue micro-loans to low-income residents who might otherwise turn to payday lenders. For each approved partnership, the Micro-Loan program makes a reduced rate deposit up to $250,000 at your financial institution for one year. You must transfer the money to borrowers in loans of up to $1,500 at least 45 days before the deposit matures. The funds cannot be used as lines of credit.
Website: http://www.treasurer.il.gov/about-us/publications/pdf/ci-micro-loan.pdf
Email: communityinvest@treasurer.state.il.us
Phone: (312) 814-1244

REAL Solutions

REAL Solutions is the signature program of the National Credit Union Foundation. Working through state credit union leagues or associations, the program's intent is to help credit unions provide new products and services to meet the financial needs of low wealth households. Real Solutions provides a comprehensive toolkit for creating payday loan alternatives, including an overview of NCUA's rules on payday loans and a state-by-state analysis of payday loan laws.
Website: http://realsolutions.coop/solutions/lending/payday-loans
Email: lkitsch@ncuf.coop
Phone: (407) 616-2409

Illinois Credit Union League

The Illinois Credit Union League is the primary trade association for credit unions in Illinois. A major partner of the Illinois Credit Union System is the ICUL Service Corporation, which helps credit unions compete through a number of products and services. The Service Corp is the League's business subsidiary and a credit union service

organization (CUSO) for all credit unions. Affiliation with the League is not a prerequisite for credit unions to receive services from the Service Corp. However, affiliation may result in lower prices for those services.
Website: http://www.iculeague.org/
Email: will.wille@ilcusys.org
Phone: (800) 942-7124

Community Bankers Association of Illinois

The Community Bankers Association of Illinois proudly represents approximately 480 Illinois financial institutions and 150 associate members. The Association creates money-saving opportunities for its members and provides first-class educational seminars and schools. Moreover, CBAI professionally lobbies for the Illinois community banker. CBAI member banks and associate members share a common belief that community banks must survive due to their role as primary lenders to consumers and the small businesses that create more new jobs than any other sector of our economy.
Website: http://www.cbai.com/
Email: http://www.cbai.com/#/About/Staff/ (Staff Email List)
Phone: (217) 529-2265

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