Developing Sustainable Products for the Financially Underserved in the United States

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Sector(s): Finance

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Location: California and Chicago, United States

Sample: Approximately 2,000 borrowers

Partner organization(s): Self-Help Federal Credit Union

Americans who have difficulty formally accessing credit from conventional financial institutions often turn to costly products such as high-interest pawn and payday loans or bank account overdrafts. Researchers in this study have partnered with a community development credit union to evaluate the demand for safe, affordable, and transparent small dollar loans, and the impact of behaviorally-informed product features on the financial capability of credit union members.

Policy issue

Many individuals in the United States have difficulty accessing credit from conventional financial institutions, or find that existing product offerings do not adequately meet their needs. Some turn to costly alternative forms of credit – including high-interest pawn and payday loans or bank account overdrafts – with effective annual interest rates frequently exceeding 300 percent.[1] Community development credit unions have a strong interest in meeting the demand for affordable small personal loans with products that are financially sustainable for borrowers and lenders alike.

This research seeks to advance the field of financial capability and provide insights for practitioners and researchers seeking sustainable and responsible methods of extending credit to low-income individuals looking to borrow in small amounts.

Context of the evaluation

Twenty-six percent of California’s population conducts some or all financial transactions outside of the mainstream banking system, according to the FDIC, and California’s concentration of alternative financial service providers (e.g. check cashers, payday lenders, and pawn shops) is approximately double the US average.[2], Classified as a “permissive state” for payday lending by the Pew Charitable Trust, California permits effective annualized interest rates as high as 459 percent, with an estimated 5 percent of its population using payday loans.[3]

Self-Help Federal Credit Union, the partner in this study, is a California-based community development credit union offering loans and financial services to underserved communities. Self-Help estimates that 75 percent of borrowers in this study will be Latino and 75 percent will earn less than 80 percent of the median income of California’s Bay Area and Central Valley.

Details of the intervention

The study will rigorously evaluate whether behaviorally-informed savings and repayment features can nudge low-income borrowers to pay down their loan balances more quickly, make a transition towards saving, and improve their financial well-being. This study focuses on two new products targeted at advancing financial capability: the Just Right $300-$1000 loan, and the Just Right $300-$500 line of credit, both of which Self-Help launched in March 2014.

The study will take place in Self-Help's 17 branches in California and three branches in Chicago. The new products will be marketed to Self-Help's Community Trust division credit union members and the check cashing clients of Self-Help's Prospera branches. Self-Help aims to open 2,000 loans and lines of credit during the 15-month enrollment period.

The study will consist of two key components: a non-randomized evaluation of alternative underwriting strategies and loan sustainability, and a randomized evaluation of add-on savings and payment features.

The randomized component of the study will evaluate three new product features that accompany the loan and the line of credit:

1. *Savings Plus*, an offset savings feature added to Just Right loans to encourage saving while borrowing in exchange for an interest rate rebate on deposits;
2. *Pay Yourself Back*, a savings feature added to Just Right loans to encourage saving after borrowing;
3. *FastPay*, an accelerated repayment feature added to Just Right lines of credit to allow borrowers to raise their minimum monthly payment in order to pay down their balance at an accelerated rate.

The features are designed to build trust, promote success, and create opportunity by helping consumers use credit products safely; specifically, they leverage behavioral tools such as habit formation and pre-commitment to help clients improve their financial health. All customers who sign up for a Just Right loan or line of credit will be randomly assigned to either a feature or comparison group, with approximately 333 clients per group.

Researchers will evaluate the impact of the products on loan repayment rates, household savings rates, and credit report indicators over a 1- to 2-year time horizon. Additionally, data on baseline behavioral characteristics of borrowers will be used to assess whether borrowers with certain traits – such as a high level of present bias or a tendency towards procrastination – benefit differentially from the add-on features.

Results and policy lessons

Results forthcoming.

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1. Bourke, Nick, Alex Horowitz, and Tara Roche. 2012. "Payday Lending in America: Who Borrows, Where They Borrow, and Why." Washington, DC: Pew Charitable Trusts.

2. Federal Deposit Insurance Corporation. 2012. "FDIC 2011 National Survey of Unbanked and Underbanked Households, ."; Self-Help Federal Credit Union. 2012. "Who We Are."

3. The Pew Charitable Trusts 2014. "State Payday Loan Regulation and Usage Rates, ."; Consumer Federation of America. " California State Information."