



Borrow & Save: Building Assets With a Better Small Dollar Loan

July 2013

This Report presents findings from the Federation's national Borrow and Save Pilot on safe and affordable small dollar loan products.
www.cdcu.coop

A Report of the National Federation of Community Development Credit Unions

About the Federation: The National Federation of Community Development Credit Unions (Federation) is a certified CDFI Intermediary representing more than 250 community development credit unions (CDCUs). The Federation's member CDCUs provide credit, savings, transaction services and financial education to more than 2.2 million residents of low-income urban, rural and reservation-based communities across the United States, and hold over \$15 billion in community-controlled assets.

Founded in 1974, the Federation is headquartered in Lower Manhattan with offices in Colorado Springs, CO and Madison, WI. The Federation offers a wide range of advocacy, educational, training, investment, marketing, and outreach programs to support and assist CDCUs. For more information about the Federation and its programs, please visit: www.cdcu.coop

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Borrow and Save:

Building Assets with a Better Small Dollar Loan

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I. Executive Summary

A. Introduction

A look at the state of financial services nationwide suggests that access to responsible, affordable credit continues to be a serious problem in low-to-moderate income communities. Payday lenders, whether store front or online, sap wealth from people of modest means. At the same time, there is clearly a demand for small dollar loans that fill an emergency need or bridge a gap between paychecks.

Payday lenders represent a multi-billion dollar industry that profits from a product designed to force borrowers into repeat loans. With each loan renewal, borrowers increasingly struggle to both repay the lender and have enough money left to cover basic expenses or an emergency.

In the wake of the recession and the explosion of consumer indebtedness, it is imperative that financial institutions promote affordable loans and effective models for accessing credit and building savings.

The good, if limited, news is that there are federal policies and pilot programs to promote availability of short-term, small (STS) loans. The FDIC sponsored a small dollar loan pilot program for banks. The National Credit Union Association (NCUA), the credit union regulatory agency, developed guidelines to expand alternatives to payday lending.

These developments provided the National Federation of Community Development Credit Unions and its members with a valuable opportunity to test, promote and expand best practices to address the urgent credit needs of low- and moderate-income people: providing access to responsible, affordable small dollar loans with terms that encourage timely repayments and break the cycle of short-term borrowing through the promotion of savings.

B. The Credit Union Response: Developing Product Solutions

Community Development Credit Unions (CDCUs) have a long history of serving low-income and minority communities by providing safe and affordable loan products and savings accounts. In the aftermath of the 2007 recession the Federation and CDCUs have looked for solutions that can provide access to affordable credit, minimize the impact of high-cost borrowing and create opportunities to build savings as a buffer against financial shortfalls and emergencies. CDCUs, with their community-based lending models, are well positioned to understand the needs of their members and to develop products with an eye to long-term outcomes.

A number of credit unions are already offering loan alternatives to consumers with limited access to credit. These small-dollar loan products have dramatically lower fees (28% APR or less) and longer repayment terms than typical payday loans. But even these significant efforts have not addressed the underlying financial instability that drives consumers to high-cost borrowing.

There is a growing understanding that in order to create the environment for significant change, we must create loans that can be repaid without the need for additional borrowing and can simultaneously foster asset-building.

C. Launching the Borrow and Save Pilot

In 2011 the Federation, with the generous support of the Ford Foundation and Morgan Stanley, launched the Borrow and Save pilot, providing grants to four CDCUs of different asset sizes and geographical distribution to provide a product that coupled a small loan with required savings. Each credit union has continued to offer the product post-pilot. The Federation's programmatic goal was the development of an alternative loan product to increase economic security and with the potential for industry-wide adoption.

The charge to the participating CDCUs was to design a loan product that was affordable and underwritten on the basis of the ability of the member to pay in the requisite time and with a mandatory savings component. Each credit union was asked to develop a plan for marketing the product and tracking member and institutional outcomes.

Over the course of 18 months through December 2012, the participating credit unions successfully developed and deployed their Borrow and Save product. The promising results of the pilot are detailed in the report that follows which provides a comprehensive overview of findings, lessons learned and implications for the industry from the Borrow and Save pilot.

D. Key Findings

The Borrow and Save pilot was launched to determine the efficacy and performance of a product that fills an immediate need for credit while strengthening longer term financial wellbeing:

Borrow and Save loans performed for the participating institutions

The loan performance findings demonstrate that Borrow & Save performed in line with overall portfolio. It is a product that serves a critical need with a reasonable and responsible amount of risk for institutions.

Borrow and Save is a sustainable product

Designed as an alternative to high cost small dollar loans in the existing market, credit unions have ample room to set a Borrow and Save rate that is responsible for consumers and profitable for the credit union while serving the asset building mission of the institution.

Borrow and Save loans can fill multiple member needs

Borrow and Save appeals to consumers and can be positioned and marketed to serve multiple purposes from basic savings to credit building and first time home buying.

Borrow and Save positively impacts the economic prospects of individual borrowers

Borrow & Save is an effective asset building tool. Credit unions report that borrowers have added to their savings and that credit scores show marked improvement.

II. Introduction

A. Background on Payday Lending and the Need for Alternatives

Payday loans are small, short-term loans carrying high fees and often with a single one-time repayment. The payday lending industry has exploded in recent decades generating an over \$30 billion in annual loan volume and promoting itself as a simple, easy way to access emergency cash. Numerous studies from the Brookings Institute, the Center for Responsible Lending (CRL) and Pew Charitable Trusts¹ have documented the adverse effects of high-cost financial services and predatory lending, particularly as the short-terms are designed to foster reliance upon rollovers and revolving cycles.

CLR reports that repeat payday loans generate \$3.5 billion each year in fees alone. Their research also demonstrates that 94% of borrowers are back to take another loan within 30 days. Though real demand for credit is far lower than what the overall volume of payday loans suggests, the short-term design forces the borrower to take out a new loan just to pay back an existing loan. These analyses of the impact of high-cost payday loans refute the argument that payday loans meet a critical market need by providing credit to cover emergencies. A July 2012 study by the Pew Charitable Trusts concludes that “most borrowers use payday loans to cover ordinary living expenses over the course of months, not unexpected emergencies over the course of weeks. The average borrower is indebted about five months of the year.”²

While there is clearly demand for credit among struggling Americans and affordable alternatives are needed it is critical when evaluating appropriate alternative products to meet this demand to identify products that are lower cost and structured to help move borrowers toward greater financial stability.

B. The Role of Community Development Credit Unions

The Federation and its member community development credit unions promote safe and responsible lending and savings. Credit unions have historically offered basic, affordable consumer loans for terms of six months and beyond, underwritten based upon the borrower’s capacity to pay.

With the explosion in the payday lending industry, the Federation has taken significant steps to encourage and support credit unions in offering alternatives to predatory loans to individuals who might not qualify for conventional loans. In 2001 the Federation developed a risk-sharing investment product, Predatory Relief and Intervention Deposits (PRIDEs™), to help credit unions make affordable small dollar loans, with the Federation absorbing up to 25% of losses.

This investment enabled credit unions to test out innovative alternative payday loan products while mitigating risk to their institution. To date the Federation has placed over \$2.6 million in PRIDE deposits at 22 community development credit unions (CDCUs), collateralizing over \$10.4 million in anti-predatory loans.

¹The High Cost of Being Poor: Reducing the Costs of Living for Working Families, Matt Fellowes, Brookings Institute, October 13, 2006; Triple Digit Danger: Bank Payday Lending Persists, Rebecca Borné and Peter Smith, Center for Responsible Lending, March 2013; Pew Charitable Trusts, <http://www.pewstates.org/projects/safe-small-dollar-loans-research-project-328781/research>

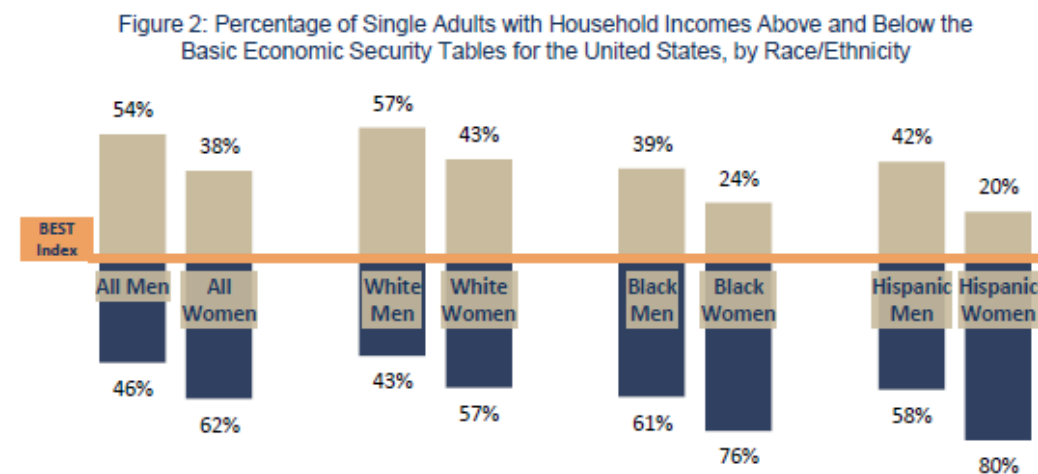
² Payday Lending in America: Who Borrows, where They Borrow, and Why, Pew Charitable Trusts, July 2012.

In 2004 the Federation initiated a program to fund reserves for anti-predatory loans with grants totaling \$250,000 to 6 CDCUs. Over 18 months the 6 participating CDCUs made over \$1.6Million in small dollar loans averaging \$765 with an average delinquency rate of 1%.

In addition, credit unions around the country have developed alternative to payday loans that have saved consumers millions of dollars in upfront fees and interest. State Employees Credit Union in Raleigh, North Carolina, offers members a “Salary Advance” loan at 11.75% annual interest rate and with a \$2.50 fee per \$500 loan, thirty times cheaper than a typical payday loan –saving SECU members over \$3.5 million each month. In Pennsylvania, credit unions are offering a “Better Choice” payday loan alternative; a 90-day loan with a \$500 limit. Since 2006, Pennsylvania credit unions with the support of the Pennsylvania Credit Union Association have made over 64,000 Better Choice loans totaling more than \$32million and saving consumers over \$23 million in fees and interest.

Credit union efforts to develop payday alternatives have primarily focused upon developing products at lower cost, returning millions of dollars to the pockets of low-income consumers. But these efforts have not addressed the underlying financial instability that drives consumers to seek these loans in the first place.

The “Basic Economic Security” table below from Wider Opportunities for Women demonstrates how a low-or moderate-income individual or household may face an expense/income gap that can lead to the use of a payday loan. The disparity between real income and the income needed by many Americans to meet basic needs can be unbridgeable. For example 62% of women nationwide fall below a level basic economic security and that number increases to 76% for Black women and 80% for Hispanic women. This disparity plays key a role in borrowing choices.



Source: Author's calculations; US Census Bureau, American Community Survey 2009 PUMS.
 Note: "Single adults" are individuals ages 18-64 living in 1-adult households, with and without children.

For a CDCU member facing a gap between income and expenses and unable to build savings, a fairly priced loan product, that includes savings and access to financial counseling, can provide a more equitable and sustainable choice.

C. The Opportunity

In the aftermath of the recession federal regulators recognized the need for responsible small dollar loan products. The FDIC launched a small dollar loan pilot program and the NCUA issued regulations with specific small dollar loan product features.

The FDIC pilot and NCUA rules were intended to address several long-standing problems with payday loans as offered at payday stores and online lenders. A typical payday loan has triple-digit interest rates and a term of less than one month, often with unlimited rollovers and multiple loans outstanding at one time, almost guaranteeing that the loan will not be paid in full in the requisite time period.

The NCUA small dollar loan underwriting parameters below represent an effort to provide a credit union product that is a potentially profitable alternative to payday loans:

- Maximum interest rates of 28%
- Maximum application fees of \$20
- Terms from one to six months
- Loan amounts from \$200 to \$2,000
- No rollovers
- Maximum limit of three loans in a six-month period
- Maximum of one loan at a time
- No credit reports required
- Total portfolio exposure of a credit union limited, as determined by participating credit unions.

The NCUA rules provided both product guidelines in the form of loan term, rates and permissible fees. In 2012, 9% of credit unions, a total of 623, were reporting on these loans for a total of \$21.2million.³ Despite this regulatory framing, very little was known about how credit unions might use alternative small dollar loan products to compete with payday lenders while promoting a better and more financial stable pathway for their members and potential members. This question along with the dramatic impact of the recession provided the Federation with the economic rationale and the opportunity to test and expand best practices with select members.

D. Designing a Pilot to Promote Financial Stability through Small Dollar Loans

With relatively few credit unions reporting separately on small dollar loans, the Federation surveyed CDCUs with existing anti-predatory loan products. We determined that many are offering small-dollar loans but with more consumer-friendly underwriting terms than those recommended by NCUA, such as required financial education and counseling to address the underlying credit issues of the borrowers and inclusion of a savings component that requires members to save while they borrow.

³ *We cannot determine from aggregated financial reports the number of federally chartered CUs that do not break out their small dollar loans from other consumer loans. Over 2,000 state chartered CUs do not have a small dollar loan reporting requirement.

Drawing on the expanding experience in the credit union movement and the results of our own research, the Federation sought to work with its members to design and pilot a small dollar loan product that would help members address their immediate needs while building a stronger financial foundation to bridge income gaps and withstand future emergencies. The Federation crafted the parameters of a product pilot with affordable and responsible loans parameters and with a key asset building component--required savings.

In 2011 the Federation issued an RFP to CDCUs for proposals to create and deploy a “Borrow and Save” small dollar loan product. The launch was supported by the Ford Foundation and Morgan Stanley. The pilot was designed to demonstrate that financial institutions can offer an affordable small dollar loan that fosters savings and can break the cycle of high-cost and repeat borrowing and be sustainable for the institution, offering small dollar loans with a savings requirement that channels and holds savings in place for the length of the loan. Based upon the findings from participating credit unions, the Federation and its partners have identified some of the most important components of a consistent, standardized product.

Participating Borrow and Save CDCUs			
	Location	Asset Size *	Membership
Union Settlement Federal CU	New York, NY	\$ 6,928,160	3,644
North Side Community FCU	Chicago, IL	\$ 10,762,869	3,347
Santa Cruz Community CU	Santa Cruz, CA	\$ 103,119,009	11,496
Freedom First CU	Roanoke, VA	\$ 292,114,693	44,932

*As of 12/2012

The Federation established the basic underwriting parameters and allowed the credit unions to develop more detailed policies and procedures based on the needs of the institutions and their borrowers.

Common Underwriting Guidelines

- A small-dollar loan (Loans not to exceed \$1,000)
- Mandatory savings requirement with percentage of savings to be determined by the CDCU
- Loan term between 6 and 36 months
- Not more than one loan out at a time
- Adherence to NCUA guidelines on maximum interest rates and fees
- Tracking of loans including repayment history, the amount of savings accumulated and the uses

Participating credit unions were selected from eighteen applicants based on their capacity to design and deliver the product and experience with grant-required data collection. Each applicant was required to include a marketing plan and goals for sustainability and scalability.

Description of the CDCU Borrow & Save Products

As detailed in the table below, each credit union developed a product that adheres to the basic required underwriting parameters while tailored to meet specific institutional and member needs.

The loan amount offered by the CDCUs ranged from minimums of \$100 to \$500 and maximums of \$500 to \$1000. Loan size was determined by the estimated demand from borrowers and analysis of the existing market for payday and other predatory loans. All of the credit unions offered loans that were long enough

BORROW & SAVE



\$500 for 90 Days

CDCU Small Dollar Loan	Payday Lender
Average 18% APR \$25 Application Fee	Fees and Interest equal to \$15 per \$100 Borrowed Every 14 days
Total Cost for 90 Days: \$40.07	Total Cost for 90 Days: \$450
Average Amount in Savings Account for Borrow & Save Product: \$30	Amount in Savings Account: \$0
Financial Education Provided	No Financial Education
Confidentiality	Personal Information Sold

to reasonably allow for repayment, ranging from 6 months to 36 months with no repayment penalties. The interest rates ranged from a low of 16.5% at North Side to a high of 25% at Union Settlement (the allowable New York State interest usury cap). Application fees ranged from no fee at Freedom First to \$25 at North Side. Union Settlement had a \$20 fee per loan, refundable upon repayment of each loan.

The required savings component varied widely, from 15% to 50%, with the savings added on to the original loan amount.

Borrow & Save Product Detail

Name	Amount	Rate/Terms	Additional Requirements
Union Settlement	\$300-\$1,000	25% APR Up to 6 months \$20 reimbursable application fee per loan Up to three loans per year	<p>15% in Savings Must be a member for 6 months All members receive financial counseling FICO scores not factored into loan decisions</p> <p><u>Savings Incentive</u> \$20 application fee is reimbursed at the end of the loan as a bonus if members make payments on time and complete the program</p>
North Side	\$500- \$1,000	16.5% APR Up to a year One loan per year per member \$25 Application Fee	<p>15% in Savings While FICO scores not factored into loan decisions, borrowers with FICO scores below 600 North Side are required to have one-on-one financial counseling sessions</p> <p>Borrowers must make at least \$1,000/month to qualify for the \$500 loan and must make at least \$1,500/month for the \$750 or \$1,000 loan. The \$500 loan is paid back in six months, while the \$750 or \$1,000 can be paid back in six months, eight months, or one year</p> <p><u>Savings Incentive</u> If a borrower saves at least \$25 per month and makes timely payments, North Side will reimburse 6.5% of the interest and half of the loan application fee. During the first year of the pilot borrowers were entered into an iPad raffle contest.</p>
Freedom First	\$250-\$1,000	18% APR 12-36 month repayment period No Application Fee	<p>50% in Savings FICO scored pulled for informational purposes only</p> <p><u>Savings Incentive</u> Upon repayment of the loan, the “saved” second portion (a minimum of 50%) of the loan funds will be available to the member as a “planned savings”. Upon successful repayment of the loan, the member will have the option to deposit a portion or all of the funds into a CD with the possibility of a preferred interest rate, only available to members that participate in this program.</p>
Santa Cruz	\$100-\$500	18% APR 6 month repayment period No Application Fee	<p>10% in Savings Requires FICO score of 600 or less Members also have access to financial counseling</p> <p><u>Savings Incentive</u> Santa Cruz will match the savings if they are able to save up to 10% of the loan in six months. At the end of the term of the loan the matched funds are released.</p>

The participating CDCUs had some underwriting and qualifications requirements in common. Each credit union had a separate Borrow and Save loan application form, required state issued I.D. and documentation of income. The loan process for existing members took as little as fifteen minutes but not more than one day.

While each credit union adhered to the Federation guidelines, CDCUs also customized their products based on market demand. Qualifying at Union Settlement required six months of membership while tenure was not required at North Side, Freedom First or Santa Cruz. North Side required that borrowers make at least \$1,000 per month to qualify for a \$500 loan and at least \$1,500 per month for the \$750 or \$1,000 loan. In addition North Side borrowers with FICO scores below 600 were required to have one-on-one financial counseling. With the exception of Santa Cruz Community CU, the CDCUs did not use credit scores to make a loan determination though they did do a “soft pull” of credit for informational purposes.

Santa Cruz Community’s product design, which originally made the loan available only to members with challenged credit (FICO scores below 600) raised a red flag for examiners. It took the credit union twelve months to get sign-off on their underwriting. As a result their data is not included here.

III. Pilot Results

A. Lending Volume and Portfolio Performance

Over the pilot period from June 2011 through December 2012, the CDCUs originated 299 Borrow & Save loans totaling \$396,316. The average loan size was \$1,381. The savings component of the program generated \$164,636, an average of \$550 per borrower. The three credit unions that were able to advance loans in the reporting period used distinctly different savings models. Delinquency rates between institutions averaged 4% and overall write-offs averaged 2.4%. A total of 59 loans, 20%, were to new members.

Aggregate Portfolio				
	Union Settlement	North Side	Freedom First	Total
Number of Loans	83	76	140	299
Total Loans \$	\$66,550	\$74,500	\$255,266	\$396,316
Total Savings \$	\$13,118	\$22,123	\$129,395	\$164,636
Savings Requirement	15%	\$25/month	50%	
Average Loan Size	\$740	\$980	\$1,823	
Average Rate	25%	16.5%	18%	
Average Term	6 months	1 year	1 year	
Savings per borrower	\$176	\$291	\$924	
# of repeat loans	20	0	2	
Delinquencies %	4.00%	3.00%	4.00%	
Write-offs %	2.00%	4.00%	1.40%	

B. Savings Outcomes

Aggregate Savings				
Credit Union	Required Savings	Total Savings	Change (%)	Savings/loan
Union Settlement	\$ 11,911	\$ 13,118	10%	20%
North Side	\$ 5,700	\$ 22,123	288%	24%
Freedom First	\$ 129,395	\$129,395	NA	51%

For the ‘Save’” portion, Union Settlement required members to deposit 15% of the loan as savings in addition to reimbursing the \$20 loan fee upon repayment. North Side required that \$25/month be put into savings or 15% of \$500 loan and Freedom First required that 50% of the loan be put into savings. The credit unions reported no resistance to the extra immediate “cost” to borrow even at the 50% level. Many Union Settlement and North Side borrowers have continued to save. As Freedom First members reach the end of their 1-year loans, they will be encouraged to move savings into a Certificate of Deposit at a Borrow & Save preferred rate.

In order to further determine the impact on borrowers we looked at the impact of accessing the Borrow & Save loan versus an average high-cost alternative, measured as savings.

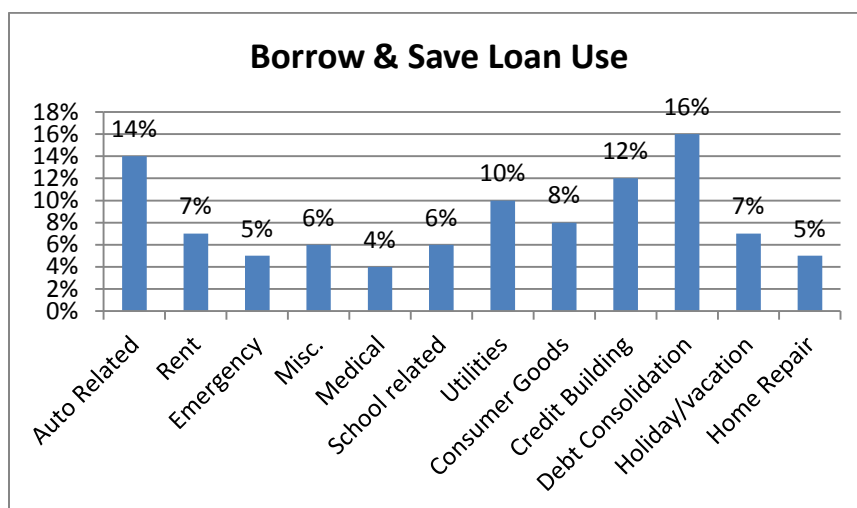
Potential Savings to Borrower from Borrow & Save Loan vs. Payday								
	Loans	Interest Per Annum	Fees	Total CU Cost to Borrower	Total Payday Cost	Difference CU and payday	Accumulated Savings **	Total Savings to Borrower
Union Settlement	\$66,550	\$16,637	\$1,660	\$84,848	\$332,750	\$247,903	\$13,118	\$261,021
North Side	\$74,500	\$11,920	\$1,900	\$88,320	\$372,500	\$284,180	\$22,123	\$306,303
Freedom First	\$255,266	\$45,947	\$0	\$301,214	\$1,276,330	\$975,116	\$129,395	\$1,104,511
Total	\$396,316	\$74,505	\$3,560	\$474,381	\$1,981,580	\$1,507,199	\$164,636	\$1,671,835

*Per annum at 400%

**Required plus additional savings by borrower

C. Product Uses and Impact

The Borrow and Save loan use parallels findings in the Pew Charitable Trusts research on payday borrowing. Over three quarters of loans were accessed for recurring or other non-emergency expenses.



Freedom First FCU,
Roanoke VA:

There are many encouraging stories. In one young man's case he had just entered the job market. He was very excited to be working and depended on his car as a crucial component of his ability to work and provide for his family. Having no credit history it was an almost debilitating challenge when he needed \$1,000 of repairs to pass inspection. He was having no luck in getting help until he learned about Borrow & Save. With this one partially secured loan he was on his way back to work, repairing his vehicle, paying back his debt and saving up for future vehicle maintenance issues that will no doubt come along the road.

76.5% of Borrow & Save loans were for expenses such as utilities, credit card bills, rent or mortgage payments or for non-emergency purposes such as vacations and consumer goods purchases. We estimate that 50% of home repair and medical expense loans qualified as emergencies, as well as all auto-related loans, for a total of 23.5% of loan proceeds for emergencies. The preponderance of non-emergency uses underscores the value supporting financial counseling and money management along with helping members to build longer-term assets.

The pilot sites also provided a detailed look at some of their borrowers, their reasons for taking a Borrow and Save loan and the impact of the product. The stories highlighted in this report demonstrate how the product's features responsibly meet needs of members.

D. Product Sustainability: Institutional Costs and Revenues

A major focus of the pilot was on product sustainability. On the table below we examine the basic fixed costs of processing, closing and servicing loans, as well as the 2012 institutional cost of funds and loan losses to determine basic profitability.

Based on this high-level analysis, Borrow & Save products generated profits for participating credit unions, ranging from 11 to 18 percent of the loan total. However there are additional associated costs that need to be factored in on a per-loan basis. These include direct borrower-related costs such as intake/underwriting, financial education and counseling as well as start-up costs such as marketing and staff training.

Freedom First calculated their additional costs at less than \$5 per loan, including the average minutes (20) per application for financial education, the median salary range for an individual who takes a loan application (\$14 per

hour). The additional costs amount to \$4.67 per application or less than 1% to the cost of each loan. North Side with a savings incentive of 3.6% per loan estimated their additional costs at 5.6% including start-up marketing costs. As with any new product there are cost efficiencies that can develop over time.

Credit Union	Union Settlement	North Side	Freedom First
Interest Rate Income	25.0%	17.0%	18.0%
Fees Income as % of loan	4%	4%	0
Loan Losses on Borrow and Save	2%	4%	1%
Cost of Funds*	.13%	.45%	.8%
Operating Cost*	9%	5%	5%
To Retained Earnings	18.0%	11%	11%

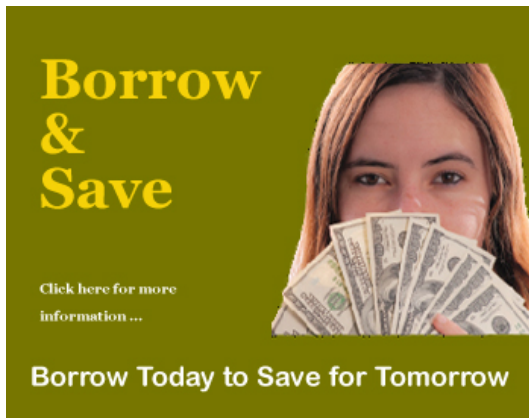
*Costs for institution based on Financial Performance Reports 12/31/2012

The calculations above represent the specific product-related business case for this product without factoring in new income to be generated from graduating borrowers into other products such as vehicle loans, other unsecured lines and even mortgages, business loans and investment vehicles. Freedom First has built this concept into their model with the goal of providing access to premium priced CDs for members who move their savings into a CD, effectively turning Borrow & Save into “Save and Invest”.

E. Marketing

Borrow & Save has elements that distinguish it from other small dollar loan products including existing alternative to payday products. A key message is that while the loans are necessary, Borrow & Save can also create an asset path. The messaging underscores the opportunity to change the course of a member’s finances and signals that the credit union is willing and able to help the borrower get there.

Participating CDCUs have effectively positioned this loan as a savings opportunity and a means to break a cycle of high-cost borrowing and clearly delineate the differences in borrowing costs between Borrow & Save and predatory alternatives.



Super Saver Loan

BETTER THAN A PAYDAY LOAN

- Borrow up to \$500
- Take up to six months to pay it back
- \$20 application fee, 18% APR*
- Built-in savings program with up to a \$50 match**
- Free financial education included

COMPARE THE DIFFERENCE

PAYDAY LOAN

Borrow \$300 from a payday lender and take six months to pay it back. You will end up paying \$270 in fees (based on renewing every two weeks and paying \$45 each time). Plus, the payday lender will add nothing to your savings account.

BORROW \$300 → PAY \$570 + SAVINGS ACCOUNT \$0

SUPER SAVER LOAN

Borrow \$300 from Santa Cruz Community Credit Union and take six months to pay it back. Pay a \$20 application fee and \$16 in interest for a total of \$36. Plus, deposit money into your savings account while you pay the loan and we'll match your savings up to \$50.**

BORROW \$300 → PAY \$336 + SAVINGS ACCOUNT \$30

SANTA CRUZ COMMUNITY CREDIT UNION

INFORMATION
 (831) 455-7700
www.sccu.org

BRANCHES

Santa Cruz
 214 Front St.
 Mon-Thurs, 9 am to 4 pm
 Fri, 9 am to 3 pm

Wilcoxville
 1428 Freedom Blvd., Ste. 1
 Mon-Thurs, 9 am to 4 pm
 Fri, 9 am to 3 pm
 Sat, 9 am to 1 pm

INSIRA

Your savings are federally insured to at least \$250,000 and backed by the full faith and credit of the United States Government. For an insured credit union, membership in the FDIC is required. Santa Cruz Community Credit Union is a U.S. government agency (NCUA) and Equal Housing Lender. We do business in accordance with the Fair Housing Law and the Equal Credit Opportunity Act.

IV. Key findings

A. Borrow and Save Loans Perform for Institutions

Data for Borrow & Save demonstrates that the product performed well for the credit unions and is in line with overall portfolio performance. It is a product that both serves a critical need and has a reasonable and responsible amount of risk for institutions.

Although the environment for small-dollar loans shifted when the NCUA promulgated its 2010 rules to encourage more small-dollar lending, these rules have not created a groundswell of small-dollar lending. Credit unions continue to have concerns about internal capacity and loan losses, and lack information about best practices that can reduce risk. Wide-scale credit union adoption is more likely with an understanding of the ability of a small dollar loan to perform for the institutions and the borrower.

	Union Settlement Borrow and Save	Overall Portfolio	North Side Borrow and Save	Overall Portfolio	Freedom First Borrow and Save	Overall Portfolio
Delinquencies	4%	6%	4.0%	4%	5.0%*	4%
Write Offs	2%	6%	3.0%	3%	1%	1%

*Freedom First counts any "Impact Banking" account that is 1 day past due as delinquent-allowing for Risk Management to contact members sooner.

The product also attracted new members. Freedom First reported that 52 individuals joined the credit union to access the product, accounting for over 1/3 of their Borrow and Save loans. North Side reported that they had interest from more than the 7 new members who joined the credit union to access the product but that overall their one week wait to set up required ACH withdrawals for payments discouraged potential borrowers. Attracting new members via Borrow and Save is both a function of the product's features and the ease of access. From a mission perspective the credit unions in the Borrow and Save pilot report that the loan is an important addition to the impact banking suite of products.

Union Settlement FCU:

Members are responding very well to the program, especially for the support that the credit union is offering them regardless of their credit score. It builds the sense of trust and liability. However, it's needed a second step in the process to not leave participating members in the temptation of spending again. This is something achievable through financial literacy, especially in a low income community where the savings concept has been inexistent.

North Side FCU:

Members have been very enthusiastic about the Borrow and Save loan product and have reported that it gives them the ability to build a savings safety net that can possibly cover emergency and other expenses that arise.

B. Borrow and Save is a Sustainable Product

From conversations with leaders in the field, we know that wide-scale credit union adoption depends in part of the ability to offer a product that, while mission driven, is sustainable for the institution. The

Borrow and Save pilot was conceived with an eye to the CDCU bottom line and the results have borne out that the product is sustainable for credit unions.

Designed as an alternative to high cost small dollar loans in the existing market, credit unions have ample room to set a Borrow and Save rate that is responsible for consumers and profitable for the credit union and serves the asset building mission of the institution. The required savings components offers additional risk mitigation that allows for favorable pricing. In the cost and revenue analysis above we looked at starting costs as well as direct and indirect costs to determine profitability. Each pilot credit union reported that the product did or could make money for the institution.

Freedom First FCU:

As the Borrow & Save loan program history grows, we see no reason why it would not be considered a sustainable offering.

C. Borrow and Save Serves Multiple Member Needs

The pilot credit unions all report that the product has appealed to consumers and can be positioned to serve multiple purposes. On the loan side the product is effectively and responsibly meeting a need: a small dollar loan with terms that are long enough to allow for repayment in full. While each credit union has positioned the product as an alternative to high-cost small dollar loans and an opportunity to build savings, they have also marketed the product in other unique ways.

North Side uses the product as part of their participation in the Federation's Better Directions Initiative on Aging, promoting their Borrow and Save loan to low-and moderate-income seniors. Freedom First markets Borrow and Save both as an alternative credit builder loan that allows borrowers to get needed cash as build credit and save and as a First Time Homebuyers product that helps members payoff collection accounts while saving for their down payments. Freedom First FCU has also built the concept of moving borrowers from Borrow and Save into a Save and Invest vehicle by offering successful borrower's access to CDs with an interest rate premium.

The majority of Borrow & Save members used the loan to fill a gap in their ability to pay recurring, non-emergency expenses, underscoring the importance of the saving component. There is a clear opportunity to meet need on the expense side while building in an "endgame" through a combination of financial management and savings.

Freedom First CU:

Freedom First has had great success in introducing the Borrow & Save Loan into our loan offerings. We have an existing Credit Builder loan product, but the challenge was always that when someone with challenged or no credit came into our branches, they 99.99% of the time always had an immediate need that they were coming to apply for loan funds for. We found that historically, to offer a credit builder loan at that point was pointless, even though the applicant had an understanding of how it worked and how it would build good credit and amass future savings funds for them to use at the end of the term, it did not change the fact that they came in with an immediate need.

We have found that this product has given our loan officers a SOLUTION to many applicants' dilemmas, and we are now able to provide them with funds for their immediate need (as is evidenced by the purposes for these loans) and build their credit and build savings for future emergency needs as well! The members that have used this loan have been very positive about it.

To further facilitate ease of adoption and reduce capacity strain on individual credit unions, the Federation will offer a turn-key solution that includes standard forms, pricing and cost analysis templates, marketing materials and best practices for product design.

D. Borrow and Save Impacts the Economic Outlook for Individual Users

One of the benefits of using a credit union is the possibility of building savings and a positive credit history- a key to long-term financial security that helps to facilitate crucial investments that can provide a foundation for other wealth-building activities (such as insurance, property rental or purchase, and small-business loans). Borrow & Save has shown itself to be a potentially effective asset building tool. Borrowers have added to their savings beyond the amount required at closing. Credits scores have shown marked improvement, increasing by as much as 50 points.

Freedom First FCU designed their product with the largest savings requirement. The following assumptions that have borne out during the reporting period:

- Borrowers would not object to paying the interest on the required amount in savings
- A meaningful amount of savings at the time of pay off would limit the need for additional loans
- Significant savings would serve as a credit builder vehicle.

The three participating CDCUs reported that there was no resistance to the savings requirement even at the 50% requirement level and that explaining and marketing the asset building potential of this product is essential. The results thus far are promising with higher amounts of required savings helping to minimize the need for additional loans.

An important corollary to the savings requirement is whether Borrow & Save can help break the cycle of repeat borrowing. While early results are promising, longer-term results are needed to make a definitive case. What is clear is that in even in the most cost-effective alternative to payday products, borrowers take our loans repeatedly each year. In the Salary Advance program at SECU referenced above, 86% of borrowers take out several loans a year suggesting that the greatest benefit of Salary Advance is the enormous cost savings for consumers on the loan side. In fact many borrowers continue to take Salary Advance Loans even as they build up enough savings to cover expenses or emergencies.

While Borrow & Save shows promise with regard to limiting repeat borrowing as savings accumulates, the short-term nature of the pilot leaves open questions about longer-term borrowing patterns. We will continue to analyze the Borrow & Save loans to determine the level of savings that best suits borrowers needs while reducing the demand for subsequent small dollar loans.

The three credit unions in this report did not use credit scores as part of the credit decision. Union Settlement and Freedom First looked at credit for informational purposes only. North Side required borrowers with credit scores below 600 to have one-on-one counseling. The modest writes-offs at the three credit unions suggests that credit scores, which averaged 550 in this pilot, were not predictive of repayment.

Santa Cruz, the fourth credit union selected for this pilot, ran into problems with their examiner when they advertised their product as available only to members with credit scores of 600 or less, despite the NCUA regulations that do not require credit scoring for STS loans. The other credit unions had no examination problems. Santa Cruz has concluded that advertising the score in the product launch raised an unnecessary red flag.

The feedback from the participating credit unions has been positive and that the product has given loan officers a solution to many applicants' dilemmas, providing members with funds for immediate need while building their credit and savings for future emergencies as well. Members have appreciated that the product gives them the ability to build a savings safety net that can possibly cover emergency and other expenses that arise.

There is insufficient evidence that this product has yet been a successful draw of traffic of new and potential members away from payday lenders. While Borrow & Save appears to provide an important addition to the credit union toolbox, the Federation and its partners will need to identify how it may best be used to move consumers away from high-cost products.

V. Next Steps: Creating a CDCU Industry Standard Product

The Borrow & Save model holds promise for the industry as we look to provide asset building opportunities for members and alternatives to predatory loans that deplete income from our members and our communities.

Later this year the Federation will introduce a comprehensive tool kit of information and materials that will enable CUs to roll out Borrow & Save for their members, including model loan policies, marketing materials, reserve expectations and staffing and operational plans. We will provide a list of critical success factors that can help credit unions develop and market the product and consumer marketing materials and other communications that educate consumers on the dangers of payday loans and benefits of a credit union alternative. The communications strategy can be implemented by credit unions and partners including faith-based institutions, and other social service providers.

A. Borrow and Save Pilot Best Practices

Effective Loan Terms

- ✓ Loan Period between 6 and 12 months
- ✓ Interest rates below 25%
- ✓ Up to three loans per year
- ✓ Loan amount of \$200-\$1,000
- ✓ No Rollovers
- ✓ No Credit Report
- ✓ Application Fees up to \$25
- ✓ Open-Ended Application for one year
- ✓ A minimum of 15% in required savings
- ✓ Refunds of portion of interest paid on amount in savings
- ✓ Make loans available to new members

Optimal Product Design

- ✓ Maximize the amount put into savings; the Borrow& Save experience show that there will be little pushback from members. Savings can cushion against losses
- ✓ Use credit scores for informational and support service purposes only
- ✓ Requiring long-standing membership to access the product does not significantly impact write-offs and minimizes membership growth opportunities and ability to market the program to the community
- ✓ Financial literacy and debt counseling are important components of the program
- ✓ Consider an open-ended loan program which can minimize paperwork and servicing. Once members have established an open-ended loan, ATMs, the phone, and the internet can be used to access and manage funds
- ✓ Small increases in interest rate to boost profitability will likely not affect uptake. Pricing is key, and whether on the APR or fees, can cushion against write-offs
- ✓ Build-in to your program design opportunities for borrowers to “graduate” into savings, investment and lower cost loan products. This works both as a low-cost incentive and an income generator for the CU
- ✓ Factor in all the extraordinary costs associated with the product to determine profitability
- ✓ Factor in other income generating opportunities from this product

Key Marketing Concepts

- ✓ Market as a positive way to build credit and savings
- ✓ Distinguish this product from other small dollar loan products in the community and at the credit union
- ✓ Incentives are a useful marketing tool but not an essential long-term “draw” for this product and can be minimized to save on costs
- ✓ Partner on the marketing with social service providers, faith leaders and other local organizations
- ✓ Open the program to new members

Union Settlement,
New York, NY:

Rodrigo C. is an 86 old senior who receives \$458 SS and \$347 SSI. Her monthly income is \$805 to pay rent and all personal expenses. Rodrigo had a family emergency; on January 11, 2012 she came to the credit union requesting a loan because her brother was ill. A Borrow & Save loan was offered and she opened a savings club account where she has saved \$37. Rodrigo finished paying her loan and \$20 will be refunded into her account.

B. Moving Forward

The Borrow & Save product has characteristics and outcomes that should stimulate widespread adoption by CDCUs. Members have immediate financial service needs that credit unions can meet. Borrow & Save can meet these needs while successfully helping individuals move along an economic security continuum towards savings and financial stability. Borrow & Save can be a transitional product rather than a long-term debt trap. For individuals who join the credit union to access the product, this is an opportunity to develop a relationship with a responsible financial institution over time.

As a pilot, Borrow & Save credit unions have had flexibility to test the parameters of possible products and there are some essential conclusions that come out of this pilot:

1. Consumers save significant amounts of money by accessing an affordable small dollar loan instead of a payday or other high-cost alternative
2. Credit Unions can meet a market demand and build membership with a safe and affordable product
3. Members can build assets through this product
4. The product can be scaled and profitable for credit unions.

The pilot demonstrates that consumer behaviors can be modified as savings develop and they graduate into other products including investments. The lessons learned have implications for the broader credit union industry. Borrow & Save is a high-quality financial product that meets low-income household's credit demand while helping to build assets and can further an essential community development credit union objective—advancing individual and household financial security.

Appendix # 1

Existing CU Alternative to Payday Loan Products

Pennsylvania Credit Union Association: Better Choice

The Better Choice Program is run by the Pennsylvania Credit Union Association in conjunction with State Treasurer's Office. The mission of the program is to transition people from predatory payday lenders towards becoming members of wealth-building credit unions.



The program, launched in 2006, is available to any current member or anyone eligible to join the credit union. The credit union reviews applications and makes a loan decision without reviewing member's credit score or past credit history. The loan provides a maximum proceeds of \$500, \$20 application fee, maximum of 18% APR, with a repayment period of 90 days. Loan payments are calculated either in weekly, bi-weekly, or monthly installments. When the loan is disbursed, an amount equal to 10% of the loan is deposited into a savings account. This amount is added to the loan balance, and the member cannot withdraw any portion of this deposit or close the account until the loan is paid back in full.

The loan cannot be rolled over and the member cannot access additional loans until the first loan is paid off. The interest the member pays on the additional 10% of the loan is rebated to the member's savings account upon repayment. The credit union also offers financial counseling to the member.

North Side Community Federal Credit Union: Payday Alternative Loan

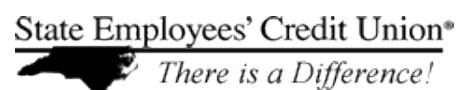
North Side Community FCU initiated their Payday Alternative Loan (PAL) program in 2002 in an effort to reach more borrowers in need while providing an alternative to payday lenders. North Side Community FCU currently offers their PAL loan with a 6 month loan repayment schedule for up to \$500 at 16.5% APR and \$30 fee. Members are not permitted to rollover their loan and/or access more than two loans per year. Members can qualify for the loan only if they were employed and those with a credit score below 600 must consent to take financial education sessions.



In 2011, 74% of loans disbursed at the credit union were small dollar loans and many of them were referred through friends or family. Currently, the loans are often used as credit building products. Members who complete financial education sessions have shown good payment records and tend to use other credit union services.

State Employees Credit Union: Salary Advance Loan Program

The \$25.5 billion credit union, headquartered in Raleigh, N. C., has provided its Salary Advance Loan program to its members as a means to short-term financing to deal with emergencies. Since inception, over 150,000 members have used the Salary Advance Loan product



and accumulated over \$20 million in savings accounts.

The product is different from conventional loans in that each time a loan advance is processed, a percentage of the advance is placed into a "Cash Account" and pledged as collateral for the Salary Advance Loan. When the balance in the Salary Advance Cash Account reaches \$500, SECU will offer a lower interest rate on the loan, dropping from 12% to 5.5%. The Salary Advance Cash Account belongs to the member and earns interest with restricted access. The member must maintain a 5% balance if Cash Account balance is below \$500 and 7% if over \$700. All withdrawals must be approved and when a withdrawal is approved, borrowing privileges on the Salary Advance Loan may be suspended for a period of time. The program requires direct deposit, zero fees and SECU offers financial counseling service at no additional cost.

Neighborhood Housing Services of Baltimore: Borrow & Save Program

Neighborhood Housing Services of Baltimore (NHS) introduced a Borrow & Save program with the Baltimore Alliance for Economic Inclusion (AEI), a coalition of banks who identified short-term, emergency loans as its first deliverable upon its creation.



Part of a national initiative created by the FDIC to foster broad coalitions and bring all unbanked and underserved populations into the financial mainstream, NHS' Borrow & Save offers a three-tiered loan program providing a range of \$400 to \$1,000 with a maximum repayment period of one year. The program offers a \$5 match for every \$5 placed into savings on a monthly basis, and borrowers must reside at or below 80% of the Area Median Income to qualify for the loan. For one-month loans, the borrower cannot take out a loan larger than 1/3 of his monthly income, and can access up to \$400 maximum.



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