Small-Dollar Lending: Help Your Customers Weather the COVID-Induced Financial Storm

Before the Competition Does

Velocity Solutions LLC
www.myvelocity.com

2021 is Here! Yet the Financial Storm Rages On

We've all waited anxiously to bid "Good Riddance" to 2020, the year that introduced us to the COVID-19 pandemic. But according to recent numbers from the Congressional Budget Office, the nation's unemployment rate will not return to its pre-pandemic levels through the rest of this decade, meaning millions could be out of work even after vaccines are widely distributed.

The current unemployment rate continues to hover in the 6.3 - 6.7 percentage range, which is dramatically higher than just one year ago, when the unemployment rate hit a 50-year low of 3.5 percent. Our economy still has nearly 10 million fewer jobs than it did a year ago, indicating that the country's job market will likely bear the scars of the pandemic recession for years.

Are you prepared to provide affordable, responsible and convenient short-term liquidity options for your customers struggling to make ends meet?

Competition in the Small-Dollar Lending Market is Growing

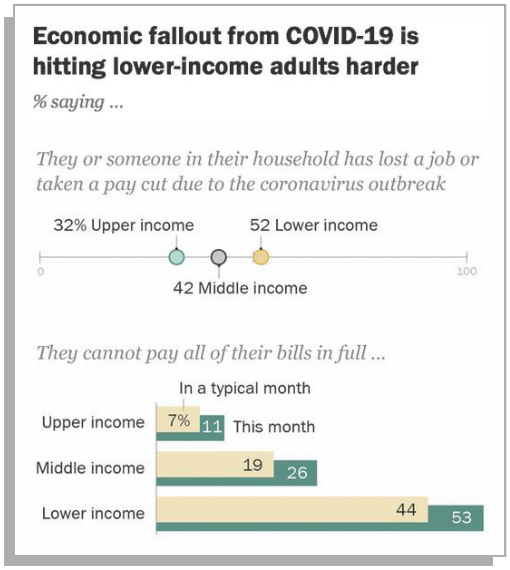
Consumers need help to weather this storm and in light of this unprecedented demand, competitors from all areas of the financial services spectrum are turning up to meet consumers' short-term liquidity needs—including 2 of the 5 largest banks in the United States. When the megabanks enter the fray, it's unquestionably time for community banks and credit unions to step up and take action. But first, we'll provide a little background to illustrate just how dire the situation has become for American consumers, and how the federal financial regulators have entreated community financial institutions to provide responsible and affordable assistance.

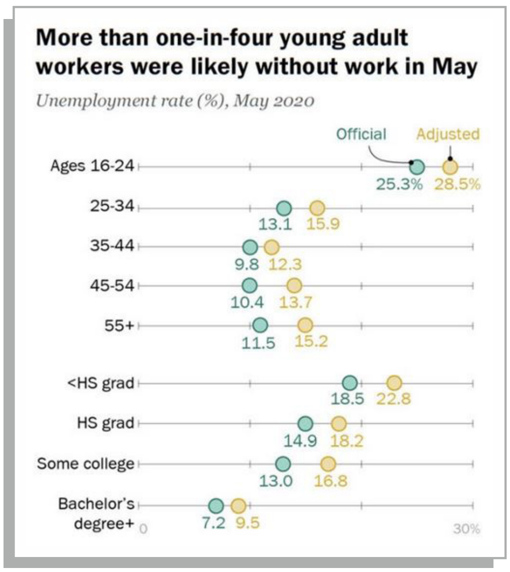
Some Consumers Have Been Hit Harder than Others

According to the Pew Research Center, about half of lower-income Americans report household job or wage loss due to COVID-19. Young adults were disproportionately at risk of job losses from COVID-19, as were the least educated and those working low-wage jobs—common demographics of workers in high-risk industries, such as restaurants/bars and other service sectors such as transportation, retail, personal care, arts & entertainment, childcare and many others.

Other common characteristics of these consumers which worsen their financial situation:

- They often don't receive benefits such as paid leave.
- They do not have the option to work remotely.
- Many do not have emergency funds.
- Many do not have access to liquidity to pay their bills. In fact, under a traditional credit scoring system, many of these workers would not qualify for loans or other types of short-term credit.
- They often have no choice but to turn to high-priced payday loans.





Federal Regulators Have Repeatedly Asked Community Financial Institutions to Provide Better Options

It's interesting to note that the primary federal financial regulators have been urging supervised banks, credit unions and savings associations to offer more responsible, affordable ways for consumers to secure short-term credit for years even prior to the pandemic. The same agencies also urged financial institutions to expand their underwriting criteria to look beyond the traditional credit score. The use of "alternative data" in credit underwriting looks at a more comprehensive picture of a consumer's ability to repay than the traditional three-bureau credit scoring model.

December 2019: Regulators Encouraged Use of Alternative Data in Credit Underwriting

In December 2019, ***all five*** of the primary federal financial regulators issued an interagency statement encouraging the use of alternative data on credit underwriting. Alternative data includes information not typically found in consumers' credit reports when applying for credit. Alternative data include cash flow data derived from reliable sources, such as consumers' bank account records. The use of alternative data may provide benefits to consumers, such as expanding access to credit and enabling consumers to obtain additional products and more favorable pricing and terms. This is a huge benefit to those lower-income Americans hit hardest by the pandemic.

March 2020: Regulators Encouraged Financial Institutions to Offer Responsible Small-Dollar Loans in Response to COVID-19

In March, 2020 the five primary federal financial regulators issued a joint statement encouraging banks to offer responsible small-dollar loans to consumers and small businesses in response to COVID-19. This statement follows years of previous comments from the same agencies encouraging better, more responsible alternatives to high-priced payday loans, long before the pandemic started.

May 2020: Regulators Encouraged Responsible Small-Dollar Lending Once Again

In May 2020, four of the five primary federal financial regulators issued principles to again encourage supervised banks, savings associations, and credit unions to offer responsible small-dollar loans to help consumers meet their ongoing needs for credit from temporary cash-flow imbalances, unexpected expenses, or income shortfalls, including during periods of economic stress, natural disasters, or other extraordinary circumstances such as the public health emergency created by COVID-19.

Small-Dollar Lending Competition is Fiercer than Ever. It's Time to Pay Attention.

Even prior to the current pandemic and potentially looming economic crisis, consumers have been exiting the banking system in search of short-term liquidity, in many cases never to return. Each year approximately 12 million Americans take out payday loans resulting in nearly $46 billion in loan volume and a staggering $9 billion in fees. Of these, 7 in 10 borrowers use payday loans for regular living expenses. And there are currently almost 16 million unbanked adults in the US. Those consumers who rely on payday loans with interest rates often greater than 400% will likely find themselves victims of payday loan traps. And the prevalence of predatory loans will likely be exacerbated by the effects of the pandemic.

The competition to meet consumers' short-term cash needs is growing exponentially because the demand is there. As a community financial institution, you might not have paid much attention to the original payday-type lenders, who have been around for years prior to the pandemic. Prosper, the first peer-to-peer lending marketplace, paved the way for a new category of small-dollar lenders that could help consumers bridge short-term liquidity gaps, further reducing the share of the small-dollar lending pie. And just within the past several years, a bevy of fintechs began sprouting up, offering apps that offered on-demand, early access to consumers' paychecks. In August 2020, Square's Cash App started testing a new feature that would allow users to borrow up to $200. Their Google ad touted "No Bank Necessary" clearly promoting the idea that traditional banking institutions are irrelevant or even obsolete. Varo Bank entered the market in October 2020 with Varo Advance, a small-dollar loan product.

Enter the Megabanks

In September 2018, U.S. Bank launched "Simple Loan," a small-dollar loan product designed to help customers deal with unexpected or short-term cash needs with a transparent, easy-to-understand installment loan. It was unusual enough to have one the nation's largest banks competing in the small-dollar lending space. But in October 2020, the banking world was stunned when Bank of America, the second-largest institution in the United States, introduced "Balance Assist," a small-dollar loan product. That means that 2 of the 5 largest financial institutions in the country are providing these offerings to your account holders.

As for credit unions, regardless of whether you normally compete with banks, these major entries into the small-dollar lending market underscore an extraordinary level of demand, and your members will need to bridge their short-term liquidity gaps somehow. Shouldn't their trusted credit union be providing that support?

SEPTEMBER 2018

AMERICAN BANKER

SMALL-DOLLAR LENDING

U.S. Bank returns to small-dollar lending. Will others follow?

By Kevin Wack September 10, 2018, 5:44 p.m. EDT 4 Min Read

OCTOBER 2020

AMERICAN BANKER

PAYDAY LENDING

Bank of America takes on payday lenders

October 08, 2020, 9:45 a.m. EDT 2 Min Read

Competitor Categories

IF YOU WEREN'T THREATENED BY THESE GUYS...	YOU PROBABLY DIDN'T WORRY ABOUT THESE GUYS EITHER...	MAYBE YOU STARTED PAYING ATTENTION TO THE NEW GUYS?	BUT NOW IT'S TIME TO GET NERVOUS
The Payday Lenders	The P2P Lenders	The Fintechs	THE MEGABANKS
LendUp	LendingClub	chime	BANK OF AMERICA
LOANSTART	PROSPER	Cash App	usbank
TinyCash	Upstart	Dave	
AdvanceAmerica	lendingtree	MoneyLion	
CashNetUSA	SoFi	FlexWage	

It's time for community financial institutions to get into the game. This pandemic has indelibly changed the way consumers think, act and behave, and community financial institutions need to stay one step ahead to preemptively act against attrition. And in this current economic crisis, one of the most critical services your account holders will need is affordable access to short-term cash. Research has demonstrated that consumers would prefer to obtain short-term credit from YOU – their trusted community financial institution, and as we've already discussed, the primary regulatory agencies also prefer that option.

Small-Dollar, Short-Term Consumer Lending – Get in the Game!

Historically, the obstacles and costs to providing short-term loans precluded community financial institutions from providing these types of loans. In the past, the two biggest impediments for community-sized financial institutions to offer affordable short-term loans were complex regulatory requirements and operational obstacles: time, cost and underwriting. But the government is already doing its part to ease up on the regulatory requirements, and the operational side of underwriting and processing these loans is made feasible with digital technology.

Digital is the Answer. Fintech Partners are the Way.

By leveraging digital, turnkey loan platforms, community financial institutions can provide much-needed liquidity to their customers—responsibly, affordably and compliantly. For community financial institutions, the most logical way to get there is to partner with a digital lending technology provider. Building a loan platform in-house is out of reach for most community-sized financial institutions due to the required expertise, resources and costs. Fintech partners also bring vast amounts of data to intelligently underwrite loans based on proven experience so you can have an expectation of what charge off rates will be before getting into this space.

With the introduction of affordable and compliant loan automation software, community financial institutions can enjoy efficiencies of automating the entire loan process and avoid the high cost of individually underwriting and documenting short-term, small dollar loans, while providing their account holders with a much-needed valuable service in these challenging financial times.

Here are just a few benefits of implementing a digital lending platform:

- Protect your account holders from falling into payday loan traps
- Prevent your account holders from being wooed away to the megabanks
- New source of revenue to your financial institutions
- Lower cost and more efficient than manual solutions
- Fully automated – no loan officers needed
- Potential for having loans automatically booked to your core
- Many fintech providers offer underwriting processes based on alternative data instead of traditional credit scores
- In most cases, your account holders can apply for a loan 24/7 on your white label website or app
- Offer a valuable service that will help acquire new account holders and keep existing account holders coming back
- Support your account holders with short-term cash so they can pay their bills and cover emergency expenses in one of the most disastrous economic crises we've seen since the Great Depression

In a time when American households are lacking liquidity in record numbers and the competitors are swooping in to meet their needs, is your bank or credit union prepared to take action? The end of the pandemic is not yet in sight. In fact, experts are warning that it will get much worse before it gets better. That means that millions of consumers across America will continue to struggle financially, and the competition will continue to emerge.

Contact Velocity Solutions to learn how you can efficiently implement a responsible short-term lending solution, using the preferred method of alternative data in credit underwriting.

Founded in 1995 and servicing the transaction accounts of over 30 million consumers and business owners, Velocity Solutions is the leading provider of revenue-driving solutions for community banks and credit unions. Our Velocity Intelligent Platform™ powers all of Velocity's solutions, using machine-led intelligence that delivers powerful analytics and drives revenue, deposits and loans to our client financial institutions.

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