

> Profiling Nonprime Consumers and Insight Into the Possible Effects of “Ability to Pay” Proposed Regulation *By Tim Ranney and Rick Hackett*

Last Friday, we had the privilege of presenting this deck to the AFSA Independents Conference General Session. Much of the deck speaks for itself, but we thought our readers might want some of the narration in the form of this post.

What’s the Source of the Data?

The deck compares random samples of between 100 and 200 thousand consumer loan records from each of four different product markets: online small dollar, online installment, storefront small dollar and storefront installment loans. The samples were drawn from much larger datasets held by Clarity. The online market data is from Clarity production information. The storefront small dollar and installment data was received for research purposes from industry participants. Each record includes application, loan terms and loan performance information. Each of the data samples was appended with Experian data for each consumer. The loan data samples span 2013 Q4 to 2014 Q1. The Experian credit information is as of 12-31-2013.

Credit History and Behavior

This section of the deck compares the distribution of consumer characteristics across each of the product markets. We included Vantage score, monthly income, credit inquiries (from the “prime credit” segmented reported by Experian), open “prime” trade lines in the last 12 months, and the number of derogatory entries in “prime” credit reports.

Ability to Repay Simulation

The recently announced CFPB proposal for regulating small dollar lending makes “ability to repay” a small dollar loan an important criterion for all of the markets represented in the deck. We attempted to simulate the CFPB’s residual income model for ability to repay in order to get some sense of the extent to which existing portfolios and applications might pass that screen.

The deck is a first iteration and we will be posting additional analyses soon. Here is what we did.

First, we took the consumer’s stated net monthly income. Then we subtracted all debt obligations reported in Experian and Clarity systems. We then used survey information from the Bureau of Labor Statistics (BLS) to model other expenses. The slide titled “Data Used” (slide 16) summarizes our methodology.

BLS reports data in three sets: expenses by income range, expenses by age, and expenses by geographic location of the borrower. We used different “buckets” of BLS data for different expense types:

- Rent, including shelter utilities expense: Zip +4 geographic
- If mortgage payment in Experian: age and income buckets for shelter utilities
- If auto debt in Experian: age and income buckets for car insurance expense
- For all consumers, basic cable and cell expense: age and income buckets

The foregoing customization is already built into the Clarity Ability to Repay (ATR) beta model. In order to complete the model this presentation used the BLS income-based distribution of expenses for food, clothing, household furnishings and gasoline/oil (if auto debt in Experian). Future iterations of the model will tailor this expense proxy methodology using all appropriate BLS data sets.


Notably, the foregoing expenses only make up about 2/3 of expenses gathered by BLS (for consumers having incomes in the \$20-\$30 thousand range). So this deck should be read as showing where consumers fall in the proposed ATR model after proxying about 2/3 of their “other” expenses. Other major expense categories include, for exam-

ple, health care (10% of expenses for consumers in the above income range), entertainment (5%) and charitable giving (5%). This proxy for expenses makes the deck most useful to compare the relative running room of lenders in various markets, as opposed to finding an absolute number of consumers in existing portfolios who might qualify under the new rules. Stay tuned for further efforts on that front.

Finally, the storefront installment (AFSA) lender data was modeled using one important different assumption from other lender types. BLS expense data is reported at the household level. The online and storefront small dollar models typically work with individual incomes of applicants. Therefore, we divided the BLS household expense data by the mean number of consumers in the BLS data for the relevant income bracket. We did not divide the storefront installment borrower expense proxy number by the number of consumers in the household, reasoning that storefront installment interactions have more opportunity to bring incomes from the entire household to the table. This may not be the correct approach, and we will model it using individual applicant shares of expenses in a future iteration. This difference in the modeling approach explains the left-hand skew of the results from storefront installment loan data.

As a way to add information around the issue of how best to proxy expenses for storefront installment borrowers, we also present residual income information for denied applicants for storefront installment loans, as compared to approved applicants.

There are many potential takeaways from this data. We will suggest some shortly. We invite your comments on what this data suggests.

The background features a light blue grid with various data visualization elements. On the left, there's a vertical axis with months 'Jul', 'Aug', and 'Sept' and percentages '51%', '75%', and '100%'. A small 'BD' label is at the top left. In the center, there are several circular icons of a person in a suit, connected by lines. On the right, there's a 3D pie chart with a slice labeled '355' and the text 'Sphere of market activity'.

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> Clarity Services, Inc.

- Founded in 2008
- Largest nonprime credit bureau in US market today
- Focused on the 72 million non-prime consumers

> About Us – nonPrime101.com

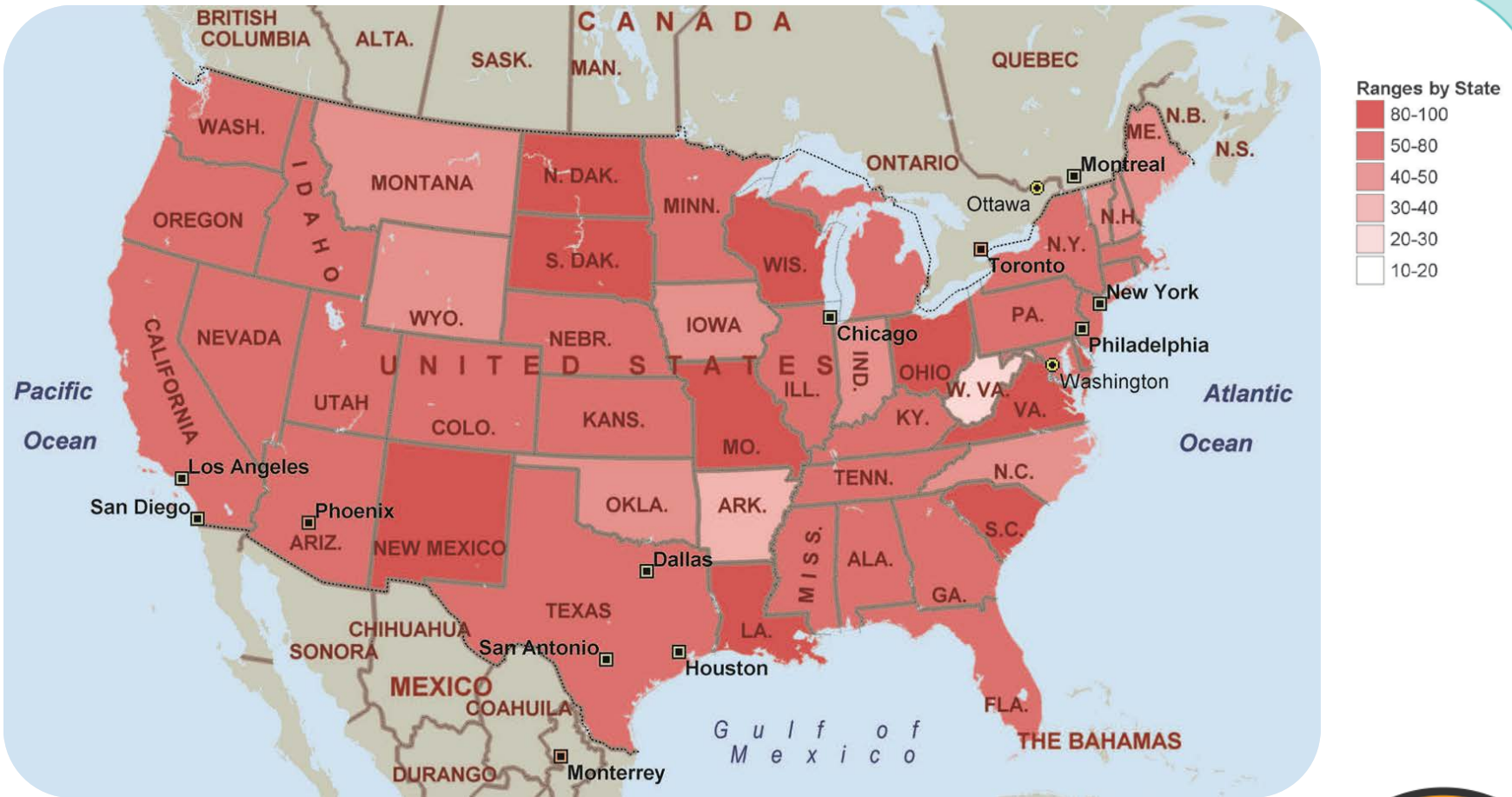
> Researchers

- > Internal researchers and analysts
- > Independent external research: MDRC, Policis
- > Contracted researchers: Rick Hackett, former CFPB Assistant Director

> Available Reports

- > Profiling Internet Small-Dollar Lending: Basic Demographics and Loan Characteristics
- > Does State Regulation of Small-Dollar Lending Displace Demand to Other Lenders
- > Measures of Reduced Form Relationship Between the Payment-Income Ratio and the Default Probability

> Clarity's Nonprime Consumer Coverage





Profiling Credit History and Behavior of Nonprime Consumers

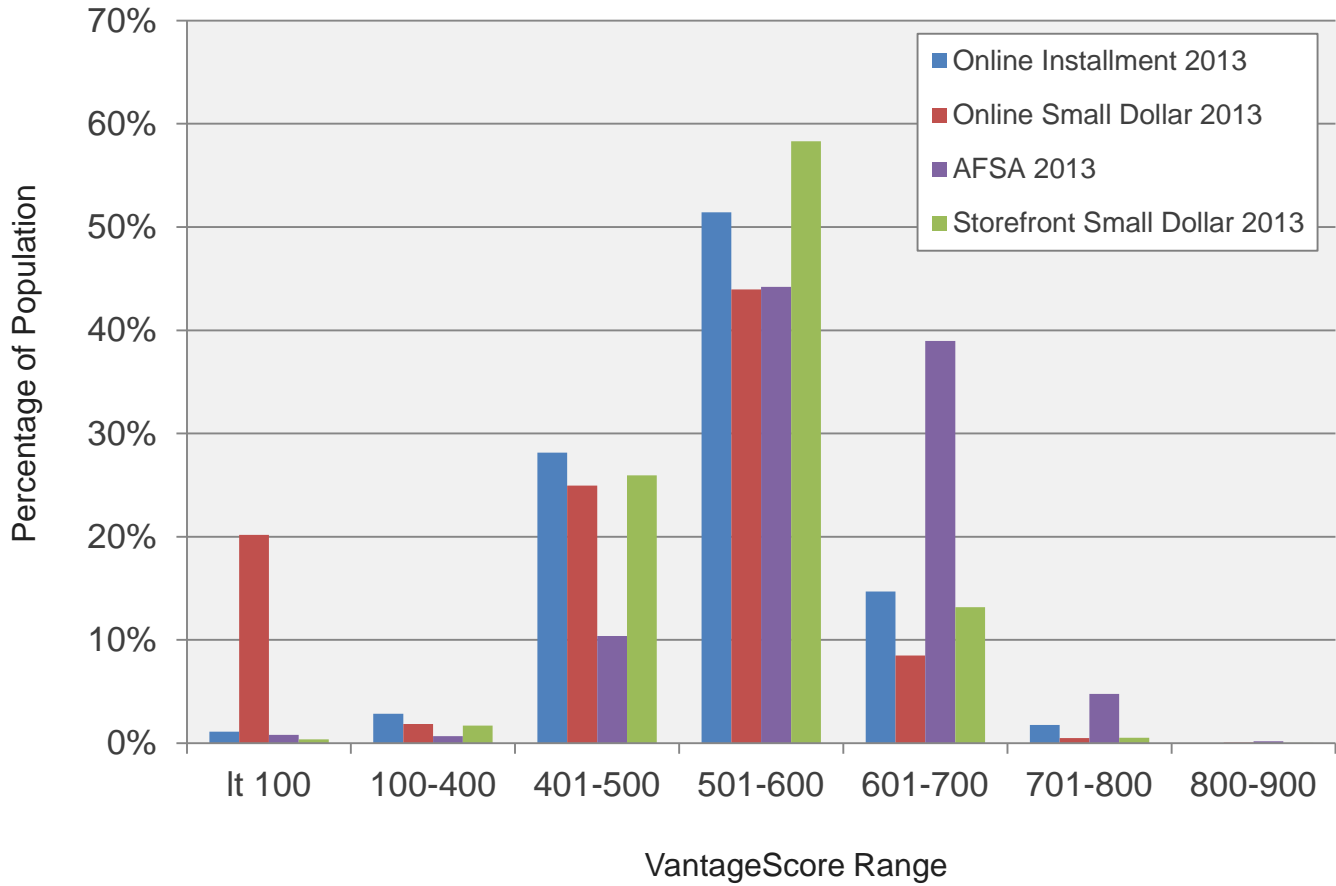
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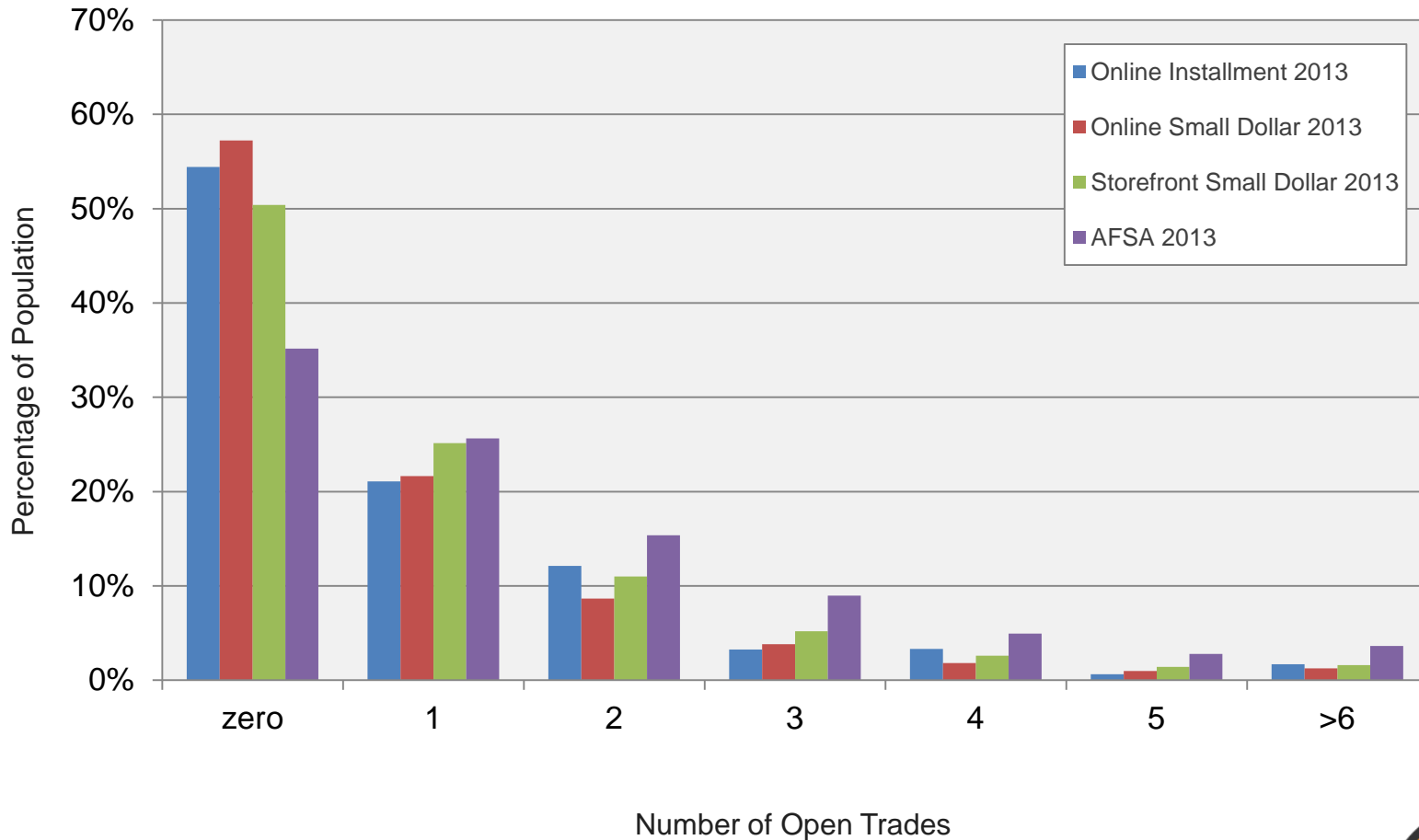
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> VantageScore Ranges for Individual Consumers

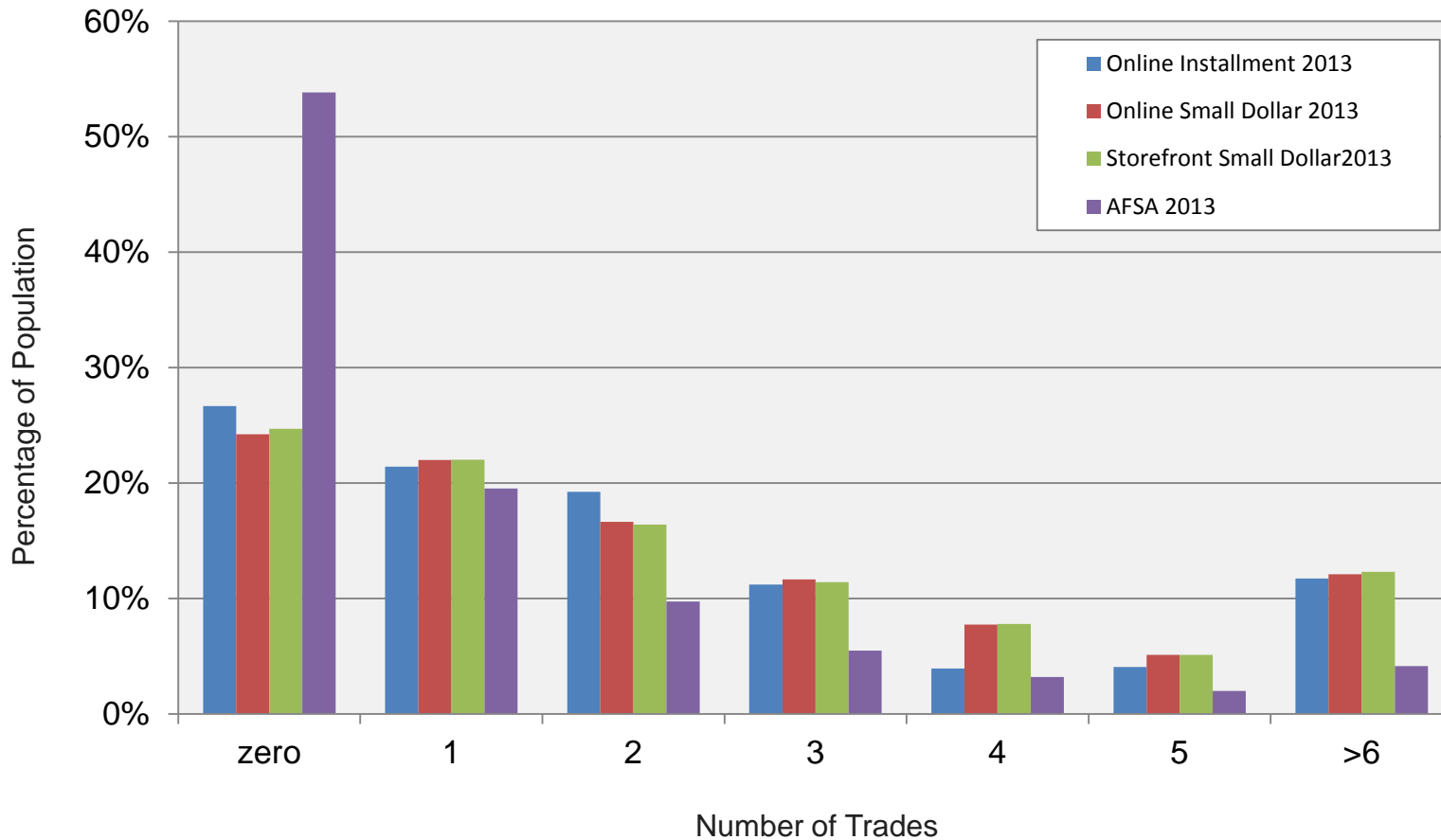


Average Vantage Scores:	
Online Installment 2013:	523
Online Small Dollar 2013:	525
AFSA 2013:	581
Storefront Small Dollar:	532
National Average 2013:	665

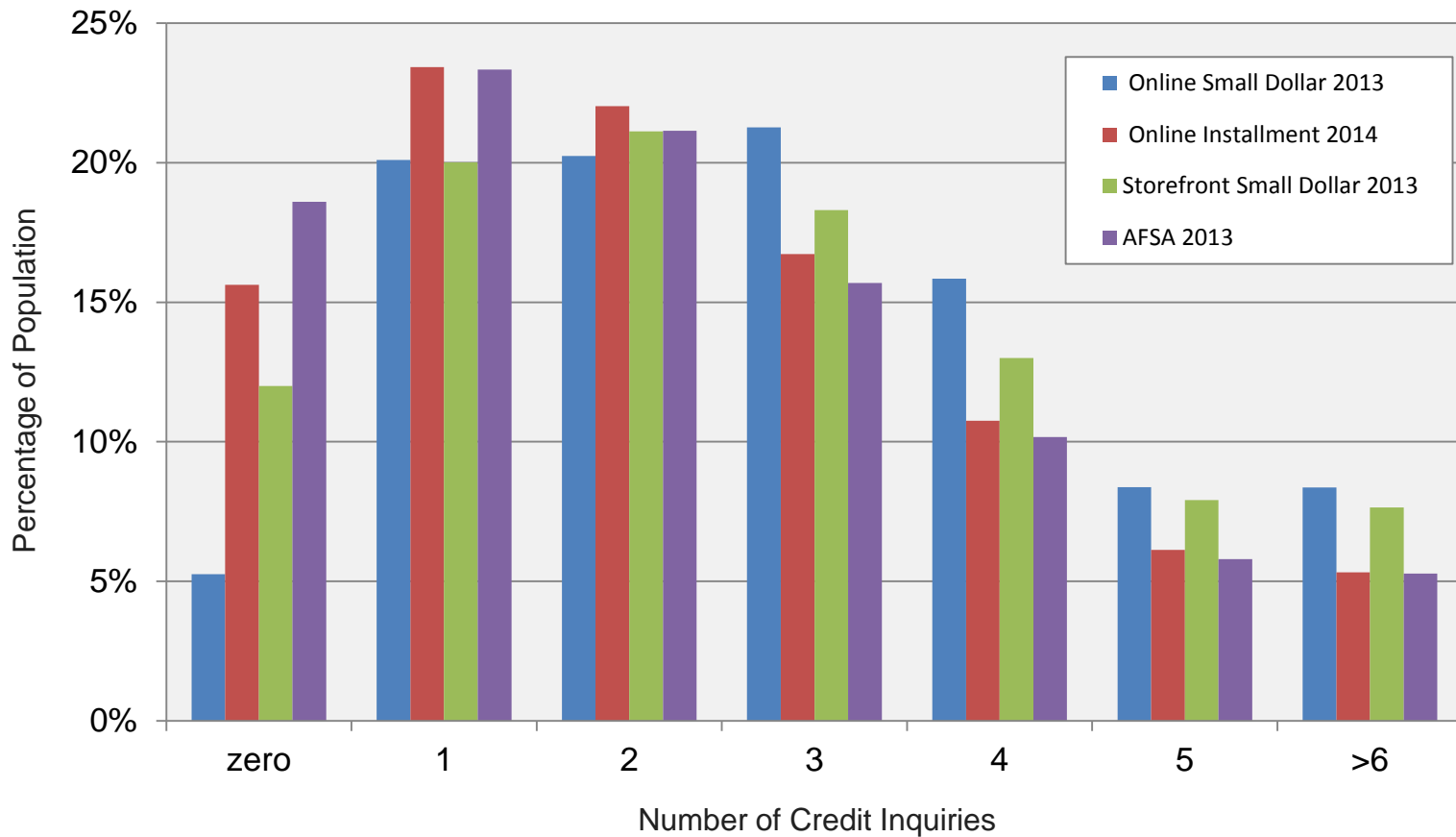
> Total Number of Open Trades in the Last 12 Months



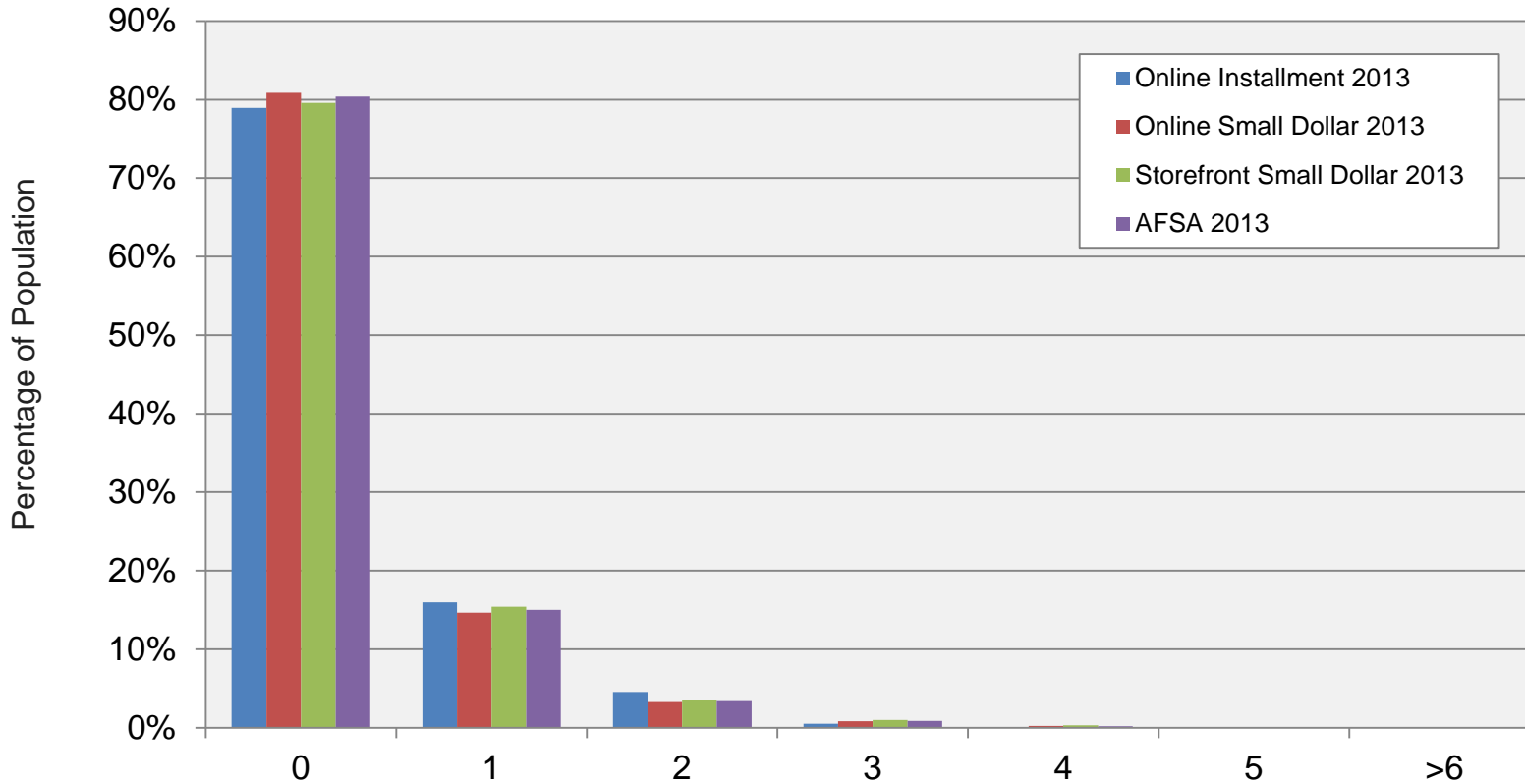
> Number of Derogatory Trades in the Last 12 Months



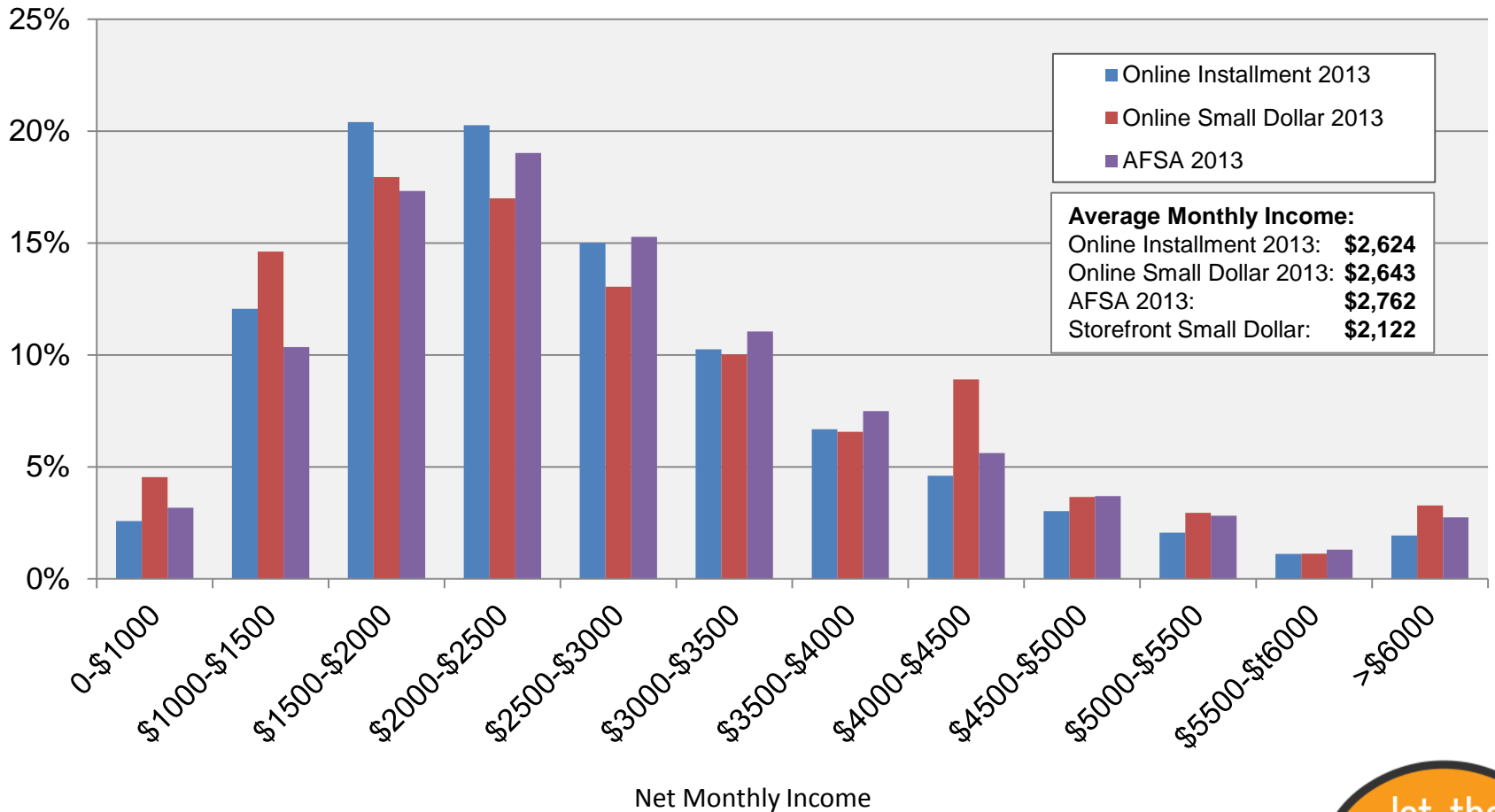
> Number of Credit Inquiries in the Last 12 Months



> Total Number of Credit Retail Inquiries in Last 12 Months



> Monthly Income Averages for 2013



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> Ability to Pay

- › Research perspective for over a year.
- › All 3 of Clarity's Research Groups have been engaged.
 - Clarity Product Development
 - Clarity Analytics
 - Clarity NonPrime Researchers

> Looking at Ability to Pay

- › Using “Loan Payment Default” as the indicator... here is what does NOT work:
 - Capping payment size using **Payment vs Paycheck**
 - Capping payment size using **Payment vs Monthly Income Ratio**
 - **Debt-to-Income Ratios**
 - **Residual Income Models**

> Promising Approach

> Consumer Break Even Analysis:

- Evaluate the monthly income
- Summarize their monthly credit and non credit obligations

If:

- **Available Income – Obligation = Breaks Even**

Then:

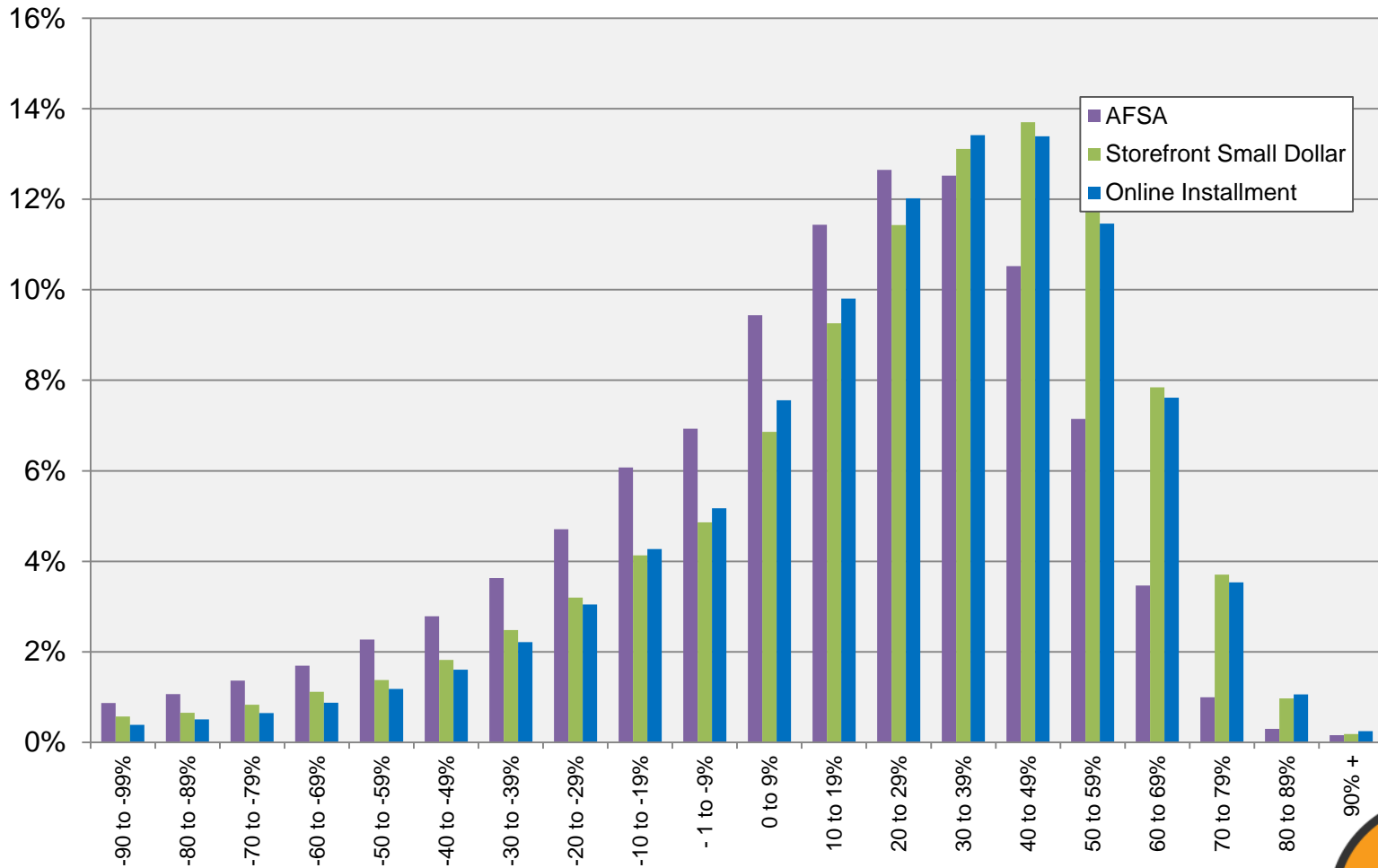
- **They are able to repay the loan regardless of the loan or payment amount**

> Data Used

Total Monthly Surplus Cash is Net Income less Traditional and Clarity Obligations less the following monthly expenses:

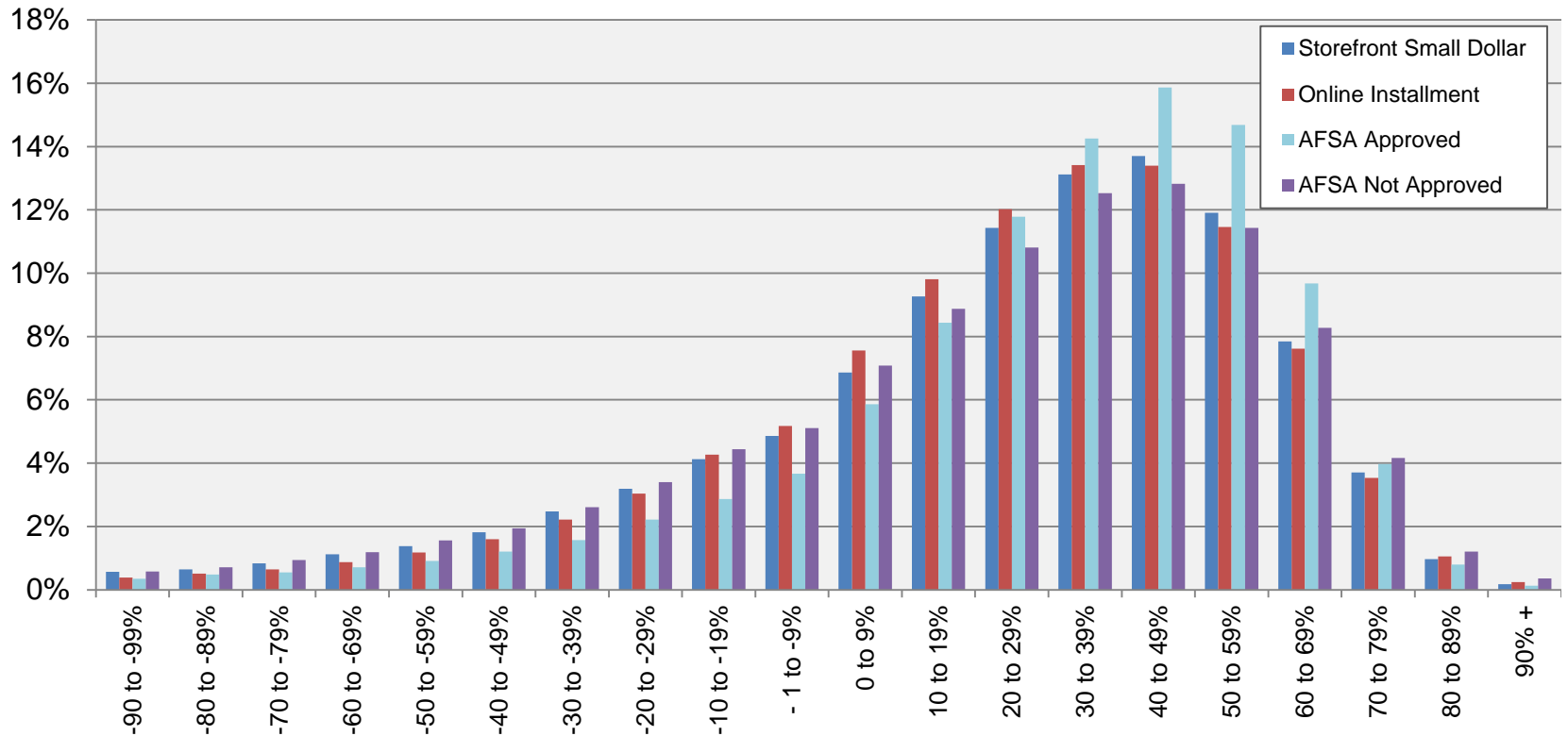
Field	Source	Detail
Median Rent	Census Bureau zip+4	Includes: Electricity, gas, water and sewer
Utilities	BLS Consumer Expenditure Survey by Age and Income buckets	Includes: Always - Basic Cable, Cell Phone. Mortgage > 0 - Gas, Electric, Water Auto > 0 - Car Insurance Individual Consumer Level
Food	BLS Consumer Expenditure Survey by Income buckets	Always included. Divided by BLS Average Number of People in Consumer Unit for Online, CFSA, and Online Installment
Household Furnishings	BLS Consumer Expenditure Survey by Income buckets	Always included. Divided by BLS Average Number of People in Consumer Unit for Online, CFSA, and Online Installment
Apparel and Services	BLS Consumer Expenditure Survey by Income buckets	Always included. Divided by BLS Average Number of People in Consumer Unit for Online, CFSA, and Online Installment
Gasoline and Motor Oil	BLS Consumer Expenditure Survey by Income buckets	When Auto Obligation > 0. Divided by BLS Average Number of People in Consumer Unit for Online, CFSA, and Online Installment

> Ability to Pay - % Residual Income - Median

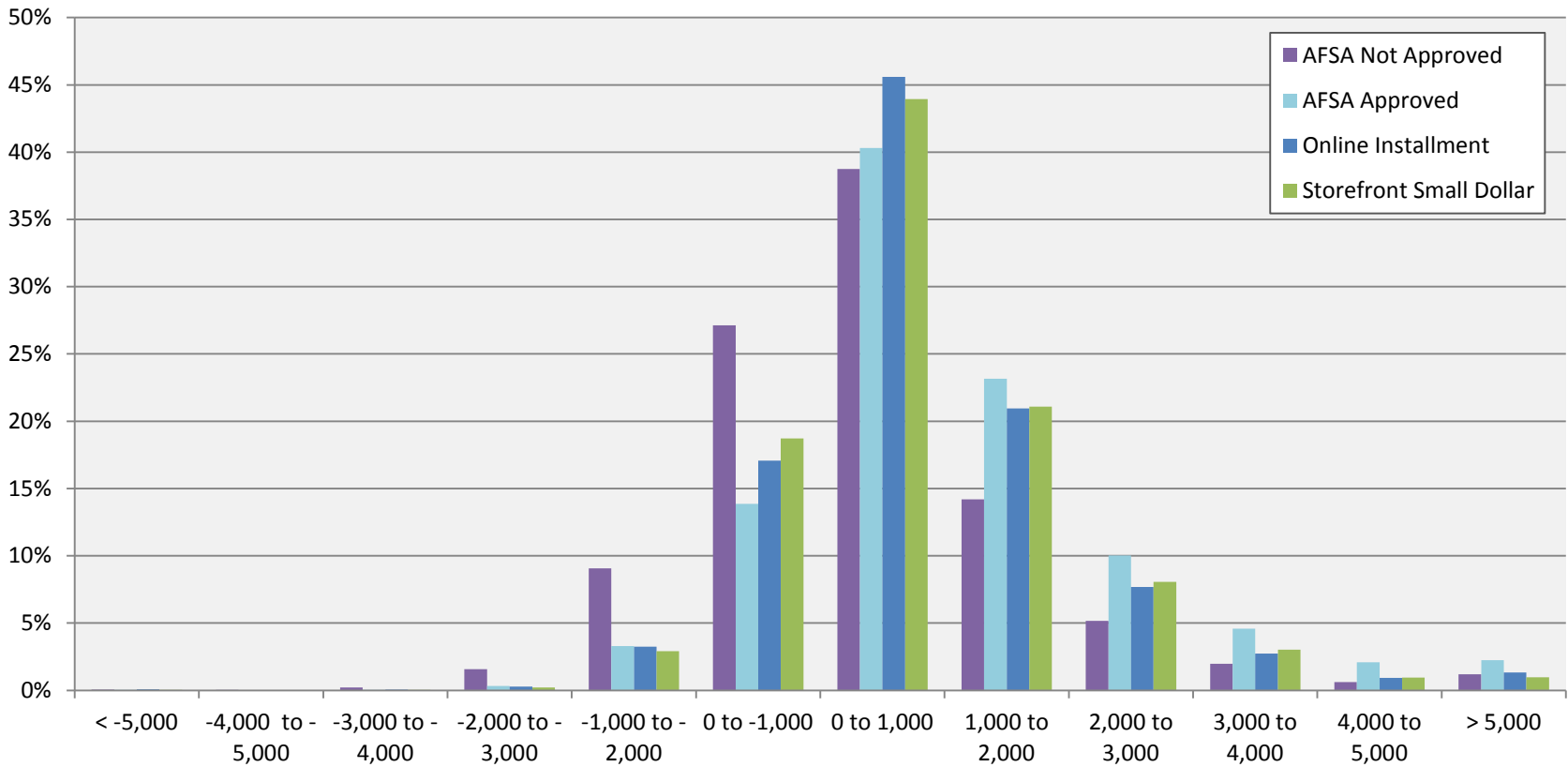


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> Ability to Pay - % Residual Income - Median

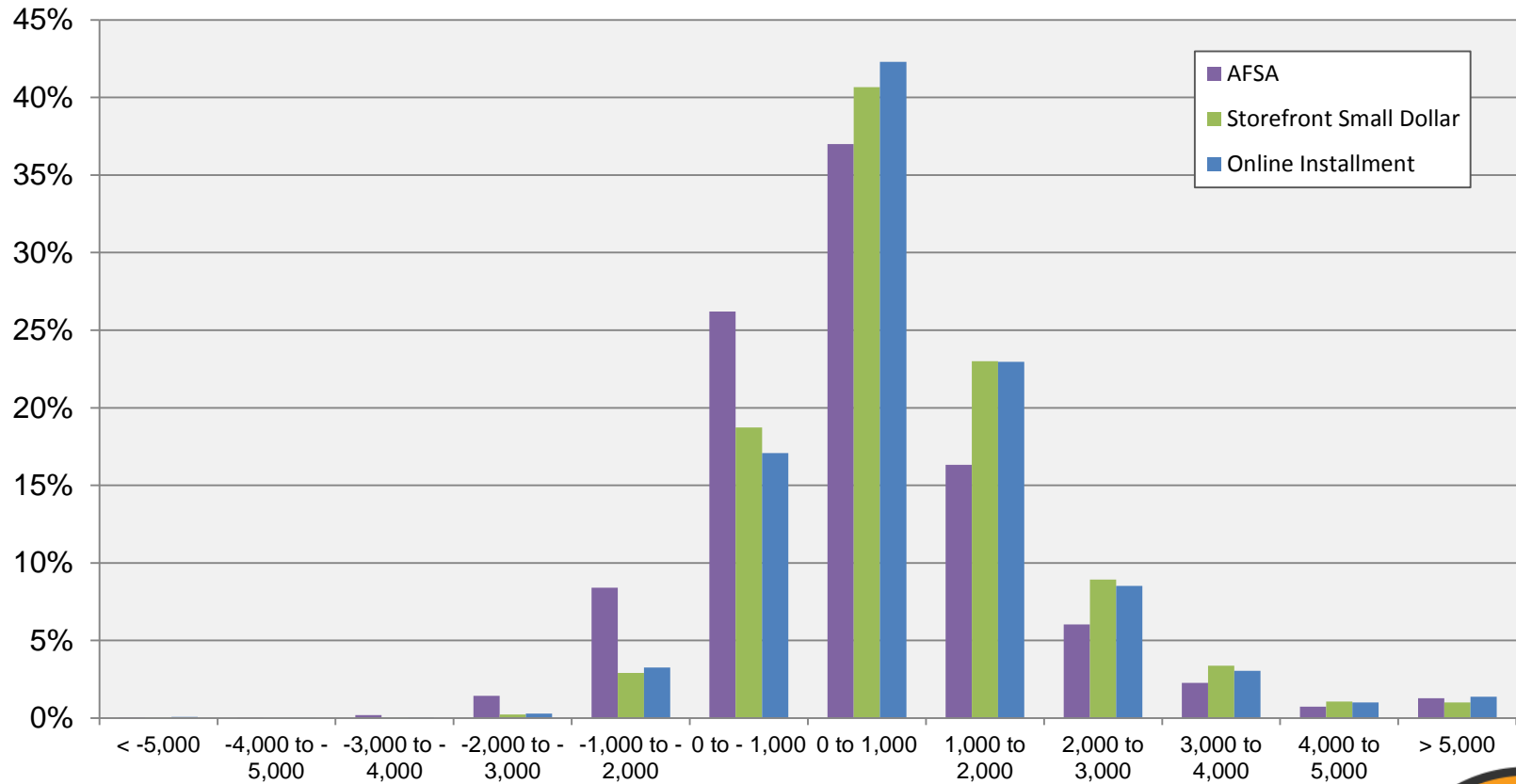


> Ability to Pay - Residual Income - Median



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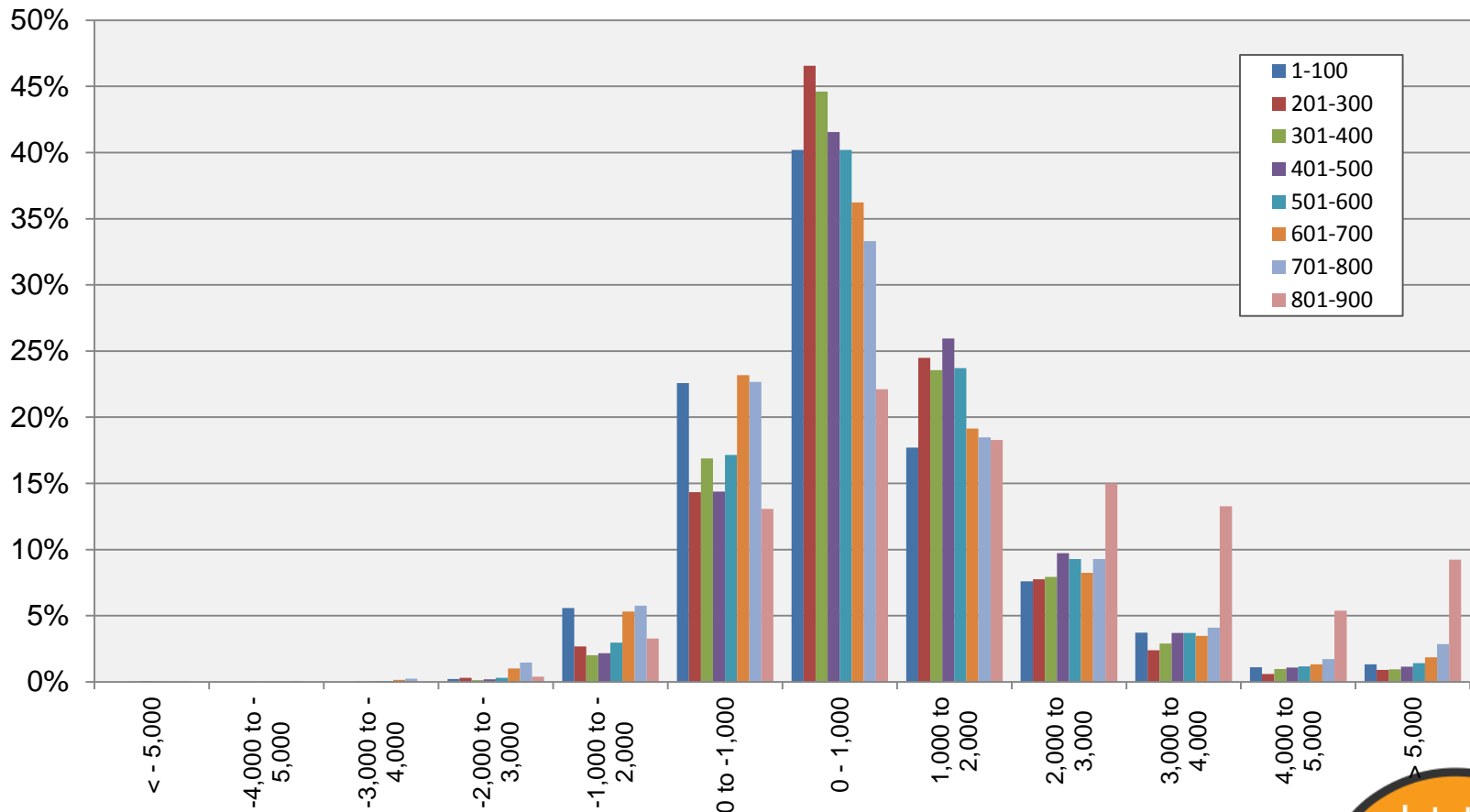
> Ability to Pay - Residual Income - Median



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Ability to Pay - Residual Income

➤ Median by Vantage Score



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CFPB Rule Proposal



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> Installment Lender Concerns in CFPB Rule Proposal

- › Staying out of the Rule: “Access to Bank Account”
 - ACH/Prepaid/Debit Card Access not allowed at closing
 - “After first payment” is allowed = consumer inconvenience
 - Why not allow any consumer-initiated process after they leave the store?

> Installment Lender Concerns in CFPB Rule Proposal

- › Complying with the Rule: Income verification
- › Proposal limited to pay stubs, bank statements (“paper, paper everywhere”)
- › What about casual/informal income (“cash is king”). What percent of low income borrowers have significant portion of income in cash? There are other ways to verify steady informal income.
- › Will all low income borrowers be limited to “on the books” income.
- › BLS CEX data says mean reported income is less than mean expenses:
 - › Net Income \$15-20k: (\$8,006)
 - › Net Income \$20-25k: (\$6,265)

> Installment Lender Concerns in CFPB Rule Proposal

- › With or without coverage under the Rule: Refinancing
- › Rule defines certain refinancing of amortizing loans as “suspect”
 - Delinquent or defaulted loans
 - Consumer articulates distress
 - Skip payment re-finance, unless “substantial” cash out

> Installment Lender Concerns in CFPB Rule Proposal

- › A UDAAP is a UDAAP, with or without a rule being supplied
- › The rule says you must re-underwrite a “suspect” refinance to show *improved* ATR
- › It applies to cross-lender activity. How do you know what underwriting predecessor lender did? Based on what?



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