Focus Group Two

Comparing Payday Loans and Two Alternative Small Loan Products

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Introduction

The second focus group, a component of the field research undertaken to examine consumer experiences with payday lending, was undertaken on 5 March 2016 in Winnipeg. The focus group participants included nine people and the purpose was to hear their thoughts regarding the strengths and weaknesses of the payday loan product available currently in Manitoba from a number of payday lenders as compared with two other small loan products found elsewhere, Vancity credit union's Fair and Fast loan, and the state of Colorado's (US) regulated payday loan. The Vancity loan is described in the Small Loan Workshop report at Tab 9 (and see table in appendix to this report for more information). This loan ranges from $100 to $2,500, has a term of 12 to 24 months, and a 19% interest rate. The state of Colorado regulates payday lenders so that they offer a 6 month payday loan, with an APR of 129%, and it involves instalment repayments. In addition to asking participants for their views about these products, they were asked about their use of payday loans, and if they had any other suggestions for improving payday loans.

Methodology

The sample of participants was selected with the assistance of a local nonprofit organization that recruited from past and present clients and some of their (clients') contacts. The group included nine participants, from diverse socio-economic backgrounds, who currently or in the recent past use/used payday loans.

The focus group discussion lasted 2.5 hours. The session began with a brief conversation about the participants' use of payday loans (see appendix for details about the format). A presentation followed that explained how annual percentage rate (APR) is a measurement that allows for comparison of different credit products. Then three models were presented –the Manitoba payday loan and the two other small loan products– and participants were asked to identify the strengths and weaknesses of each product, in addition to their overall preference.

Participants Socio-economic Background

Participants were aged from 25 to 67 years old, with half of the participants between the ages of 25 and 45 and the remaining four in their 60s (Table 1). The majority of participants were women. Seven of the nine participants have children under the age of eighteen living with them. Half the participants are single while the other half are married or common-law. Nearly half of the participants are unemployed, while two are retired, two work full-time and one is a seasonal worker. Annual household incomes ranged from $11,600 to $45,000. One participant did not provide their annual household income.

Table 1: Demographics of Focus Group Participants

Age (years)	Marital Status	No. of Children <18 yrs. old in Household	Annual Household Income ($)	Employment Status
25	Single	4	-	Full-time
29	Single	1	30,000	Full-time
32	Single	1	17,500	Unemployed
36	Married	5	25,000	Seasonal worker
44	Common-law	2	22,800	Unemployed
62	Married	0	11,600	Unemployed
66	Single	0	13,000	Unemployed
66	Married	2	45,000*	Retired
67	Married	2	45,000	Retired

*The original figure provided by the participant has been corrected to reflect the same annual household income as their spouse who was also involved in the focus group.

Results

Frequency & Period of Use

Frequency of payday loan use varied considerably. Four of the participants reported using payday loans 12 time a year (i.e., once a month), while two participants use them 4-6 times a year. After getting caught up in using multiple payday lenders at one time in order to pay off previous loans, one participant did not trust them for a long time and now only accesses payday loans in emergency situations, though he did not specify how often.

One participant who has been using payday loans for roughly 25 years reported a personal record high of engaging with ten payday lenders at one time until he was eventually forced to declare bankruptcy. Because of the family's difficult financial situation, and because he could no longer obtain payday loans, his spouse began to take them out. They continue to use payday lenders and, as a couple, they currently use two pawn shops and one pay day lender about once a month.

Purpose for the Payday Loan

There were a wide variety of purposes expressed for requiring payday lender's services, including:

- To pay for things which they might not otherwise be able to buy
- To carry them over between paydays, CPP cheques, tax returns, etc.
- In emergency situations or when faced with unexpected expenses
- To pay off previous loans
- To meet basic needs (food, transportation, pay off bills, etc.)
- To support addictions (i.e. gambling, alcoholism, drug-use)

Why Payday Loans?

When asked why payday loans as opposed to borrowing from a bank or credit union, the most common reasons indicated by the participants were bad credit and/or convenience. For those with a history of bad credit, their use of payday loans was less a choice and more of a necessity, as they were unable to access the services of mainstream financial institutions (FIs) during a time of need.

The majority of the participants expressed that they turned to payday loans because of the convenience. Additionally, some participants liked the short-duration of the loan, the quick acquisition process, and the simplicity of repayment. Two of the participants shared that payday loans are such an easy way of getting 'extra cash' that they simply use them for shopping and avoid high interest rates by repaying the loan early.

Other participants, however, found the loans easy to get but difficult to pay off, particularly as a result of the high interest. A number of participants reported using multiple payday loans at once and becoming stuck in a cyclical trap of taking out new loans in order to pay off their previous loans.

The participant with the longest history of payday loan use in the group expressed that,

> *This pull they have, they make it so-called 'easy', which is a blind spot because of the interest you're paying back [Focus group participant quote].*

Among focus group participants those who are less financially stable and access payday loans because of poor credit appear to be particularly vulnerable to this risk, as compared to those who simply use the loan for extra cash and do not struggle with repayment.

Strengths & Weaknesses

Participants were asked to describe the strengths and weaknesses of the three credit products. From the responses we identified 4 key points related to interest rate, repayment structure and duration, loan size, and credit reporting.

Interest Rates

When presented with the three different small-loan models, focus group participants were largely in favor of Vancity's Fair & Fast loan model because of its lower interest fees. Most of the participants agreed that the 517% APR on Manitoba payday loans is too high, instead favoring the Vancity model that has an APR of 19%.

Two participants said they are satisfied with Manitoba payday loan fees, particularly because the interest is reduced if the two-week loan is paid off early. These individuals use payday loans about 3-6 times a year as an easy way to get extra money to be able to buy things in between paydays and CPP cheques.

Repayment Structure & Duration

A portion of the group identified the installment repayments and possibility of early repayment without penalty as the main strengths of the Colorado state model product. As for the Fair & Fast Loan offered by Vancity, the group was split between those who felt the long-term and installment payments was a strength and those who felt it was a weakness. Those who saw it as a strength did not like the one-time repayment structure of the Manitoba payday loan. They would prefer to pay the loan back slowly.

Those who saw it as a weakness were adamant that they preferred to pay off their loan within the two week period that is standard in Manitoba. These participants were committed to not getting caught in a longer-term repayment obligation. They strongly endorsed the Manitoba payday loan model:

You don't have to worry about it for a long time [Focus group participant quote].

Loan Size

The larger loan which is available through the Vancity model was appealing to some of the participants because it allows users to get a larger sum of money as compared to the Manitoba payday loan. One participant acknowledged that a larger loan could potentially help those who are stuck in a cycle of repeat borrowing because you would be able to pay off more money at a reduced rate. However, others saw it as a temptation to borrow too much and be unable to repay. One participant who shared this concern noted,

Having a large amount is difficult because you maybe can't trust yourself with it [Focus group participant quote].

Some of the participants were not interested in the large loans offered by Vancity because their credit needs were more modest. Most participants agreed that the USD500 maximum offered by the Colorado state model was an inadequate amount.

Credit Reporting

Some participants stated that they felt that a strength of the payday loan system in Manitoba is that there are no background credit checks and no credit reporting. Some participants expressed concerns that they would not be approved for a loan through the Vancity model which assesses users' credit scores prior to providing the loan. The opportunity to build their credit rating did, however, appeal to a few participants who expressed support for this feature of the Vancity model and said they would rather have the loan repayments appear on their credit record. Although they were conscious of the fact that failure to make payments on time could actually hurt their credit scores, the opportunity for improvement remained an attractive feature.

Discussion

In the process of investigating different small loan models we found that some payday loan clients prefer the current Manitoba payday loan while others prefer other options, most notably the Vancity Fair and Fast loan (see Small Loan Workshop Report for description). In some cases people used payday loans infrequently and in other cases participants used them frequently. We heard stories of participants being harmed by payday loan dependence and stories of participants who were helped by using the loans in a strategic fashion. Although even the strategic approach may be inconsistent with the perfectly rational agent that economic theory posits, this strategy seems consistent with bounded rational behaviour – a view promoted by behavioural economists (Thaler and Sunstein 2008, Mullainathan and Shafir 2013) – that real people follow when they are subject to time and institutional constraints.

Several focus group participants explained that for them there were few alternative loan products. Some of them were unable to get credit from mainstream banks, due to bankruptcy, or a poor or no credit rating. For some of these participants, friends/family and pawn loans were one of the few options for these underbanked people. However, relationship-based loans and pawn loans are small as compared to payday loans. Also, pawn loans require depositing a household item with the pawnbroker.

Some respondents noted that due to the high cost of repaying the loan they fell into a dependence on payday loans. Two participants who took out at least twelve payday loans per year struggled with addiction issues. They noted that the consequences of their personal and financial struggles were bankruptcy or accumulating unrepayable debt. For these participants, payday loans were not helping them, but were delaying their need to address personal and financial issues. Moreover, the accumulation of unrepayable debt added an additional challenge.

Other borrowers did not take out as many loans, perhaps 3 to 6 per year, and referred to other reasons for using the loans, such as convenience and ease of accessing them. Some of these focus group respondents talked about using payday loans in a more strategic way in that they limited the number of loans they would take and these funds would be devoted to certain items, e.g., paying particular bills, or for emergency purposes. One respondent explained that she had adequate savings to pay for bills, but preferred to use payday loans for some bills in order to keep her savings intact. This approach to using payday loans is consistent with 'mental accounting,' a term used in behavioural economics (Shefrin and Thaler 1988), associated with a bounded rational strategy undertaken by individuals facing constraints. Rather than seeing money as perfectly fungible, it is understood to fit in different categories, e.g., employment income, benefit income, emergency expense, gift expense.

The principal purpose of the focus group was to explore participants' views about alternative financial products. Several respondents were quite interested in the Vancity loan because of its longer term and lower annualized interest rate. They felt that this loan would be easier to pay off because of the installment plan and the lower fees.

Some participants preferred the short term one-time repayment for reasons described as 'less worry' and 'pay it off and be ok for a little bit.' Other participants talked about 'not trusting' oneself with a larger or longer-term loan. For them, the small-sum and short-term loan offered them the discipline to limit their borrowing. Once again these strategies seem consistent with a bounded rational strategy in which people are making decisions with limited information, time, and self-control. For them there is a benefit to short-term, one-time repayment so that this product is worth the cost.

Two types of payday users became apparent through the focus group conversation:

- Those who are able to use small loans from time-to-time, in a strategic fashion, and are able to repay them in a timely fashion, and
- The more vulnerable repeat borrowers who eventually become dependent on the loans.

In this way, the ease of accessibility and the convenience of Manitoba's current payday loan system can help some borrowers and harm others. The credit-challenged payday loan users appeared to be the most vulnerable to potential risks and would benefit most from an alternative product.

References Cited

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Appendix: Focus Group Conversation

Regarding the format of the conversation:

- We will ask the question and then go around the group allowing each person adequate time to respond. We want to hear what each of you has to say.

- We want to be sure to hear from everyone so we may need to stop someone from elaborating too much. In this case if he/she likes he/she can share with us after the meeting verbally or in written form.

- We also want to hear you talk together about certain issues and appreciate points that you agree on or disagree on. We require that if there is a disagreement that mutual respect guides the conversation.

Preliminary Group Questions

1. Please describe how often you use payday loans, how long you have used them, and any other services you use payday loan lenders for?

2. Why do you use payday loans?

Presentation

Facilitator explains important features of loans in general, payday loans in particular, and then two to three models.

Annual Percentage Rate, APR

- Loans are a commercial product and involve
    - A seller and buyer, or creditor and borrower
    - A price, which is called an interest rate: mortgage, small loan, credit card, credit line, etc.

- Fringe bank products like payday loans are sometimes priced in different ways, for instance in a dollar fee, e.g., $17/ $100 borrowed
    - This presentation makes it more difficult to compare the payday loan fee with the fee for other loans

- For instance, in Manitoba, payday lenders often advertise their loans as costing $17/$100

- Some people believe that this is equivalent to a 17% APR
- In fact $17/$100 loaned is the fee for a 12 day loan, or a 17% interest for 12 days. To convert it into an annual interest rate, e.g., APR, we must do the following:

APR = Fee/Loan x 1/Share of term in the year

17/100 x 365/12 = 5.17 = 517%

Typical Manitoba payday loan compared with the Vancity Fair and Fast Loan and the Colorado state model

- Explain these different products:

Character	Payday Loan in commonly found in Manitoba	Vancity Fair and Fast Loan	Colorado state (US) model
Loan size	< $1,500	$100-$2,500	<USD 500
Duration	2 weeks	12-24 months	6 months
Repayment	One-time; ‘balloon’	Installment	Installment; Early repayment possible without penalty
Approval process	60 minutes first time; less time for 2nd loan and beyond	Rapid	Rapid
Credit report	Not applicable	Use alternative report to assess; loan use is reported	Not applicable
Fees in 2 weeks on a $300 loan	$51	$2	$15
Annual percentage rate	517%	19%	129%
Fees in 1 year	$1,224 [If you were able to take 2 x 12 =24	$57	$387

	consecutive payday loans]		

Responses from Participants

3. Can you share with me the strengths and weaknesses of these two models

   - Please, before you share your preferred model, I would like to hear what you think are strengths and weaknesses of each

4. If both were available to you, which – one or both – would you use?

   - If you think about the last time that you needed a small loan, and when you took out a payday loan, if you had these two options, which would you choose?

   - Or, in future, when you face a small credit need, and if both of these were available, which one would you choose?