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INSIDE THIS ISSUE

- The use of nonbank credit, such as payday, pawnshop, and refund anticipation loans and rent-to-own agreements, increased even after the Great Recession.
- Nonbank credit rose disproportionately with populations normally considered economically advantaged: older, nonminority, better educated, married, and higher income.
- More than 7 million households used nonbank credit within the 12 months prior to June 2011.

The Rising Use of Nonbank Credit among U.S. Households: 2009–2011

Gregory B. Mills and William Monson

In the aftermath of the Great Recession of 2007–2009, many American households are searching for new ways to cope with major losses to income and wealth. The depth and pervasiveness of the recession, combined with the weakness of the recovery and slow job growth, have meant many workers and their families have needed additional resources to make ends meet.

In such circumstances of need, households respond in different ways as they try to avert hardship. Typically, they reduce expenses and draw down available liquid assets. They may then seek financial support from relatives, friends, charitable organizations, or public means-tested income assistance. Depending on their credit standing, they may be able to obtain loans from banks, credit unions, or thrift institutions.

Those unable to access mainstream bank products turn to credit sources in the informal, nonbank sector, also referred to as the alternative financial services market. For increasing numbers of households during and after the recession, this has meant using high-cost nonbank credit products such as payday loans, pawnshop loans, rent-to-own agreements, and refund anticipation loans.

This brief reviews recent use patterns of nonbank credit, as measured through national data collected by the Census Bureau in January 2009 and June 2011.[1] These two iterations of the National Survey of the Unbanked and Underbanked were funded by the Federal Deposit Insurance Corporation (FDIC) and were implemented as supplements to the January 2009 and June 2011 Currently Population Survey (CPS).[2]

The Upward Trend in Nonbank Credit Use from 2009 to 2011

The use of nonbank credit increased between January 2009 and June 2011 (figure 1).[3] The percentage of total households with one or more members having ever used one or more of the four nonbank credit products rose from 11.8 percent in January 2009 to 14.2 percent in June 2011.[4]

> Almost half of alternative credit users indicated that they needed nonbank credit for basic living expenses. The FDIC interpreted growth in this percentage as suggesting a rise in financial distress.

Four nonbank credit products were examined in the 2009 and 2011 National Surveys of the Unbanked and Underbanked:[5]

- **Payday loans,** unsecured short-term loans that represent an advance on the borrower's next paycheck. The amount is typically $250 to $350, with a two- or four-week payback. The customer writes a personal check for the advance plus a fee that averages $15 to $20 for each $100 borrowed. The lender advances the funds to the borrower and then holds the check until his or her upcoming payday. Borrowers typically roll over these loans (at an additional fee) in multiple transactions.

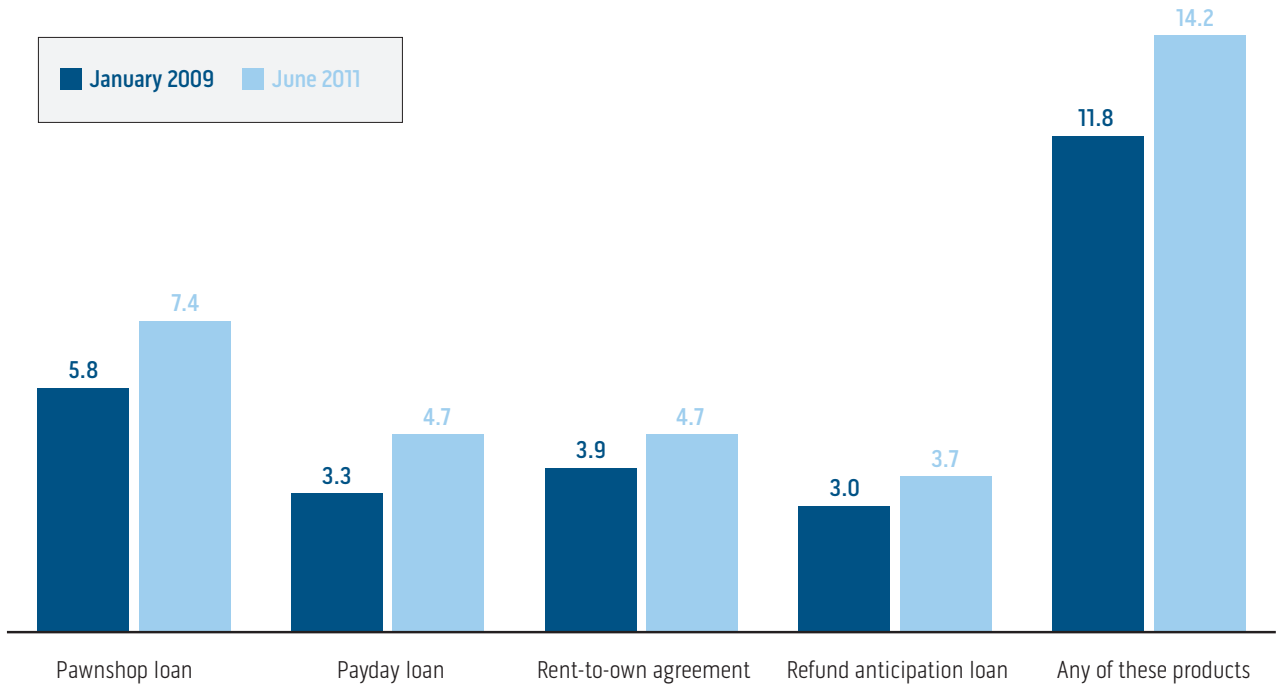
- **Pawnshop loans,** short-term loans secured by an item of property, often a piece of jewelry or an electronic item. Typically, the loan term is one month for an amount less than $100. If the customer repays the loan and the fee, the pawnbroker returns the item. If the customer does not repay by the expiration date, he or she forfeits the item and the pawnbroker can sell it.

- **Rent-to-own agreements,** self-renewing weekly or monthly leases for merchandise items—typically, furniture, appliances, home electronics, or jewelry. A customer making timely regular payments, which can be weekly, biweekly, or monthly, acquires the item at the end of a 12- to 24-month contract period but relinquishes the item upon nonpayment. For example, a customer might make weekly payments of $12 for 78 weeks to purchase a $500 television, paying $936 in total. (If the customer is unable to make payments beyond week 52, he or she returns the television after having paid $624, or $124 more than its worth.)

- **Refund anticipation loans,** unsecured short-term loans that constitute an advance on the borrower's anticipated income tax refund. The customer receives the amount of his or her tax refund from the lender (less a fee) before he or she would otherwise receive a refund from the Internal Revenue Service.

Among these products, a payday loan is the only one requiring the customer to have a checking account. The customer's household would thus be classified as "banked" under the definition used in the FDIC survey.

Figure 1. Percentage of U.S. Households Ever Using Nonbank Credit, 2009 and 2011



Source: FDIC (2012, tables 29, 33, and 35).

Notes: For refund anticipation loans, the 2009 data indicate households that used this product during the last five years. All other 2009 data and all 2011 data indicate those who had ever used the indicated product. The 2009 estimate of 11.8 percent represents a 2010 reestimate of the original estimate of 11.6 percent, reflecting technical revisions.

Table 1. Characteristics of Households Ever Using Nonbank Credit, 2009 and 2011

	PERCENTAGE DISTRIBUTION OF EVER-USER HOUSEHOLDS	
CHARACTERISTIC OF HOUSEHOLD OR HOUSEHOLDER	January 2009	June 2011
Age		
15–34	37.5	31.0
35–44	25.8	23.3
45–54	22.3	22.3
55–64	9.9	14.8
65 or older	4.4	8.5
Race and ethnicity		
Black	27.5	24.9
Hispanic, non-Black	13.8	12.6
White, non-Black, non-Hispanic	54.9	59.1
Other	3.8	3.4
Education		
No high school diploma	19.3	15.6
High school diploma	35.9	35.4
Some college	34.6	35.3
College degree	10.2	13.7
Homeownership status		
Nonhomeowner	37.6	43.1
Homeowner	62.4	56.9
Household type		
Female householder, no husband present	26.3	24.0
Male householder, no wife present	8.4	7.4
Nonfamily household and other	29.6	31.4
Married couple	35.7	37.3
Household income		
Less than $15,000	25.2	26.1
$15,000–$29,999	25.6	25.8
$30,000–$49,999	26.4	22.5
$50,000–$74,999	13.4	14.5
At least $75,000	9.4	11.1

Sources: FDIC (2012, table A-30); FDIC (2010, table A-1).

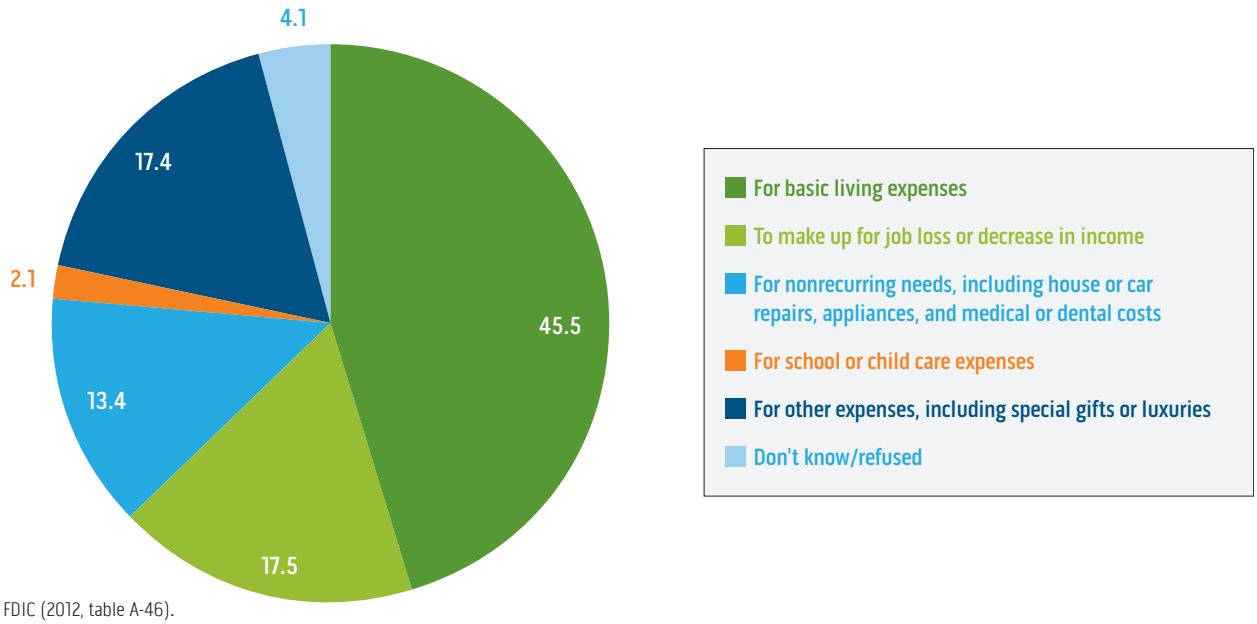
Among the four products, payday loans showed the largest proportional increase in use, from 3.3 to 4.7 percent. This partly reflects the increasing availability of Internet payday loan products, even in states that have banned such loans. Pawnshop loans were the most widely used product at both intervals, with ever-use rates of 5.8 percent in January 2009 and 7.4 percent in June 2011. The growth in use of refund anticipation loans was likely slowed by the Internal Revenue Service passing regulations in 2010 and 2011 that made it more difficult for tax preparers to market such products to low-income, high-debt tax filers. Rent-to-own agreements were the slowest-growing segment of the nonbank credit market but still showed approximately 20 percent growth in use over the 2009–2011 interval, with the ever-use rate rising from 3.9 to 4.7 percent.

The Changing Demographic Profile of Nonbank Credit Users

A shift occurred between January 2009 and June 2011 in the demographic composition of the household subpopulation that has ever used nonbank credit. This reflected the differential rates of growth in nonbank credit use across subgroups. Note, however, that all subgroups experienced some increase in use.

People who did not use nonbank credit in the past became increasingly likely to do so between 2009 and 2011 (table 1). For example, the ever-user population increasingly comprised those with the following householder characteristics: older (i.e., 55 years and older), not a minority (i.e., non-black and non-Hispanic whites), and more educated (i.e., with some college or a college degree). Additionally, the ever-user households increasingly comprised married couple households or nonfamily households (versus families with an unmarried male or female householder) and higher-income households (i.e., with annual income greater than $50,000).

Figure 2. Main Reason for Needing Nonbank Credit among Recent Users, 2011



Source: FDIC (2012, table A-46).

Table 2. Households Recently Using Nonbank Credit, 2011

	HOUSEHOLDS USING NONBANK CREDIT DURING LAST 12 MONTHS, JUNE 2011		
	Thousands of households	As % of total U.S. households	As % of ever-user households
Pawnshop loan	3,520	3.0	39.3
Payday loan	2,063	1.7	36.7
Rent-to-own agreement	1,814	1.5	32.2
Refund anticipation loan	1,449	1.2	32.4
Any of the above	7,243	6.0	42.3

Source: FDIC (2012, tables A-32 and A-34).

These patterns demonstrate that the adverse effects of the recession on household economic well-being were felt across a wide range of economic and demographic subgroups. Nonbank credit use was pushed higher during the postrecession period in all demographic subgroups, but disproportionately so in segments of the population normally considered economically advantaged: older, nonminority, better educated, married, and higher income. Nonhomeowners were the notable exception to this pattern, perhaps because many former homeowners, having lost their homes to foreclosure and no longer having any housing equity to draw down, turned to nonbank credit sources.

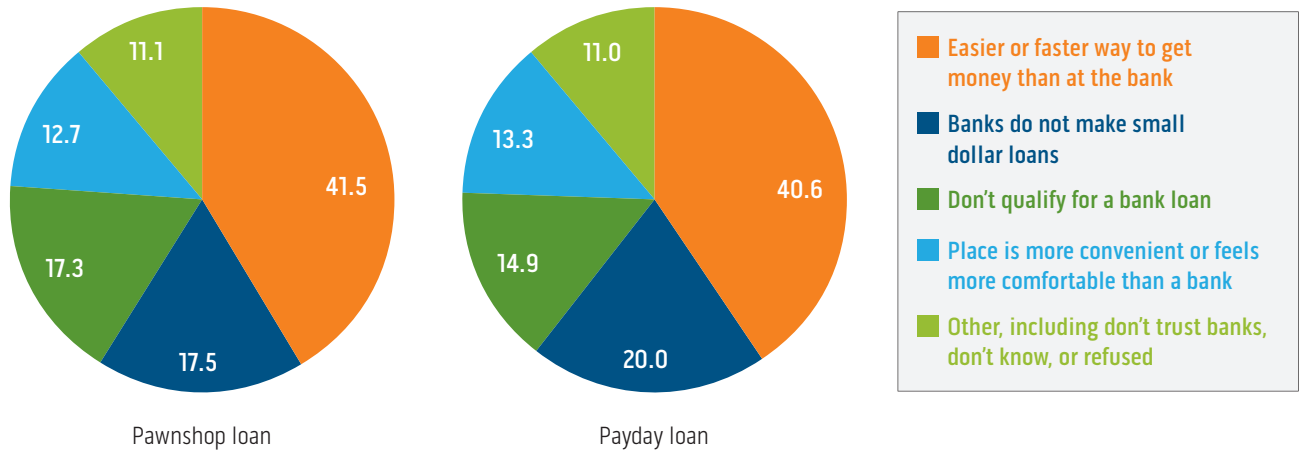
Postrecession Household Use of Nonbank Credit: 2010–2011

More than 7 million households, 6 percent of all households, used nonbank credit within the 12 months prior to June 2011. For each nonbank credit product, table 2 shows the share of ever-user households surveyed in June 2011 that indicated having used that product within the last 12 months. Approximately one-third of the ever-users indicated using each type of nonbank credit product within the past year. For those who ever used any of the four products, fully 42.3 percent were users of at least one product within the most recent 12 months. Among those recent users, approximately one in six used nonbank credit for the first time.[6]

Shifting Reasons for Needing Credit and for Using Nonbank Products

For those using nonbank credit within the past 12 months, figure 2 shows the main reason for doing so. A large percentage of alternative credit users (45.5 percent) indicated that they needed nonbank credit "for basic living expenses." The FDIC report interpreted

Figure 3. Main Reason for Ever Using a Pawnshop or Payday Loan, 2011



Source: FDIC (2012, table A-45).

the growth in this percentage, from 34.5 percent in 2009, as "suggesting a rise in financial distress" among households.[7]

Households cite different main reasons for using a pawnshop or payday loan (figure 3). In June 2011, a large percentage of pawnshop ever-users (41.5 percent) and payday loan ever-users (40.6 percent) indicated such products were "an easier and faster way to get money than to qualify for a bank loan." In order of importance, another 17.5 percent of pawnshop users and 20.0 percent of payday borrowers said "banks do not make small dollar loans." This was followed by those saying that they "don't qualify for a bank loan"—17.3 percent for pawnshop loans and 14.9 percent for payday loans.

Implications of the Upward Trend and Shifting Composition of Nonbank Credit Use

Between January 2009 and June 2011, through the depths of the Great Recession and the early phases of a sluggish recovery, the percentage of households that had ever used nonbank credit rose from 11.8 to 14.2 percent. This increasing reliance on such lending sources has come at a high cost. The annual percentage rates for such products are typically cited in hundreds of percentage points (routinely above 400 percent for payday loans). The amount paid annually in interest, fees, and charges by American consumers (many from low-income households) for nonbank borrowing is in the billions of dollars. The Center for Responsible Lending has estimated, for instance, that the rollover (or "churning") of payday loans results in borrowers paying $3.5 billion in fees each year.[8]

A key question for policymakers—particularly for the governmental institutions with regulatory authority over small-dollar loan providers—is whether the interest, fees, and charges associated with such borrowing are commensurate with the risks assumed by the lenders. The FDIC surveys indicate that 20–25 percent of these user households have annual incomes of $50,000 or above. Attention should focus on ways to encourage product development in the mainstream financial services market, to better attract and serve the more credit-worthy nonbank clients and thus enable these households to access short-term credit more affordably. At the same time, the less credit-worthy households are likely to require longer-term strategies that combine savings incentives with financial education and appropriately priced small-dollar loans. ▪

Notes

1. According to the National Bureau of Economic Research, the Great Recession began in December 2007 and ended in June 2009. See NBER (2010). As is typical, the unemployment rate continued to rise for several months after the recession's end, peaking at 10.0 percent in October 2009. Atypically, however, the unemployment rate has remained elevated for several years. In June 2011, it was 9.1 percent. See BLS (2013).

2. See FDIC (2009, 2010, and 2012). The FDIC survey respondents make up 86 percent of the CPS participants in January 2009 and 84 percent in June 2011. The number of respondent households was 46,500 for the January 2009 supplement and 44,900 for the June 2011 supplement.

3. The comparisons between 2007 and 2009 require attention to methodological changes adopted by the Census and FDIC between the two surveys. CPS household respondents were excluded from the June 2011 supplement if they did not participate in the household's financial decisions. Such individuals were included in the January 2009 supplement. For some measures, the 2009 estimates were later recomputed using a methodology consistent with the 2011 published tabulations. FDIC's report on the June 2011 findings and the reestimated 2009 findings stated, "It is worth noting that the revised 2009 estimates are not materially different from those in the 2009 report" (141). Another difference between the two surveys relates to the reference period for refund anticipation loans. The 2009 survey asked whether respondents had used this product within the past five years, whereas the 2011 survey asked whether they had ever taken out such a loan.

4. This difference is statistically significant at the 0.10 level.

5. For further discussion of these nonbank credit products, see Theodos and Compton (2010). Note that auto title loans were not included in either the 2009 or the 2011 FDIC survey.

6. The survey does not ask about first-time nonbank credit use, but the share of recent users who are new users can be approximated by combining information from the 2009 and 2011 surveys. Both surveys provide data on ever-use of nonbank credit, which is a cumulative measure—one expects it to rise over time. Thus, the increase in ever-use from 11.8 to 14.2 percent between January 2009 and June 2011 translates into a 1.0 percentage point increase per year in the ever-user share of the population. This implies that, of the 6.0 percent of households that used nonbank credit products within the 12-month period ending June 2011, approximately one in six were new users, versus prior users, of such credit.

7. FDIC (2012, 38).

8. Parrish and King (2009, 13–14).

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Unemployment and Recovery Project

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