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Consumer use of payday, auto title, and pawn loans

Insights from the Making Ends Meet Survey

CFPB Office of Research

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Consumer Financial Protection Bureau

Introduction

Payday loans, auto title loans, and pawn loans are often called alternative financial services (AFS) because the typical lender is not a bank. These loans are typically for relatively low amounts—typically less than $1,000—high interest rates, and short durations—typically a month or less. While the exact terms and structure of these loans can differ from lender to lender, payday loans are typically given in advance of a consumer's payday for a fee; auto title loans use the title to the consumer's auto or other vehicle as collateral; and pawn loans typically use some valuable item, like a computer or jewelry, as collateral.

The "mosaic" of existing research on these products is still incomplete, leaving many unanswered questions.[1] In this research brief, we examine the prevalence, persistence of use, and alternate credit sources available for consumers who use payday, auto title, and pawn loans. We use the first two waves of the Bureau's Making Ends Meet survey, conducted in June 2019 and June 2020, to examine how consumers use these services over time. The survey is associated with traditional credit bureau data, allowing us to examine other credit characteristics such as whether these consumers appear to have readily available credit on credit cards. The Making Ends Meet survey thus gives us a rare opportunity to combine a survey of the same consumers over two years with credit record data to understand consumers' decisions about debt.

In June 2019, 4.4 percent of consumers had taken out a payday loan in the previous six months, 2.0 percent had taken out an auto title loan, and 2.5 percent had taken out a pawn loan. Because the number of consumers using these loans in the survey is small, there is some survey uncertainty in these estimates, but the estimates are similar to other sources.[2] The share of consumers who had used these services in the 12 months before June 2020 was similar, but the increased length of time considered and the start of the pandemic means the results are not completely comparable across waves.

The survey results show that consumers frequently roll over these loans or take out a new loan soon after re-paying the previous loan. In June 2019, of the consumers who had taken out a loan in the previous six months, 63 percent still owed money on a payday loan; 83 percent still owed money on an auto title loan; and 73 percent still owed money on pawn loans. Repeatedly rolling over or revolving loans is not unique for these kinds of loans. For the 79 percent of consumers

[1] J. Brandon Bolen, Gregory Elliehausen, and Thomas W. Miller Jr. "Do Consumers Need More Protection from Small-Dollar Lenders? Historical Evidence and a Roadmap for Future Research," 2020, *Economic Inquiry* 58: 1577-1613. Available: https://doi.org/10.1111/ecin.12894.

[2] We compare these results to the FDIC Survey of Household Use of Banking and Financial Services below.

with a credit card in the survey, for example, 51 percent did not pay the full bill in the previous month in June 2019.

Use of alternative financial services appears to have fallen early in the pandemic. In June 2020, the share of consumers who still owed money on a payday loan fell to 48 percent (from 63 percent), the share for auto title loans was mostly unchanged, and the share for pawn loans fell to 34 percent (from 73 percent). The longer time period covered in June 2020 may also have allowed consumers who took loans out more than six months ago longer to repay. These changes during the pandemic are consistent with other reporting suggesting that many consumers paid credit card debt, pawns loans, payday loans, and other debts during the pandemic as consumer spending fell while average incomes rose because of government transfers.[3]

For each of these loan types, use tends to be persistent from year to year. Comparing across the two waves, 52 percent of consumers who had taken out a payday loan in the six months before June 2019 had also taken out a payday loan in the 12 months before June 2020. The corresponding numbers are 32 percent for auto title loans and 56 percent for pawn loans. For comparison, 81 percent of consumers who were revolving credit card debt in June 2019 were also revolving in June 2020.

Consumers using alternative financial services frequently have difficulty paying a bill or expense and are more likely to have experienced a negative financial shock. In the survey, 77 percent of consumers using alternative financial services experienced a shock and had difficulty paying a bill or expense during the same timeframe in which they also reported borrowing a payday, auto title, or pawn loan. For consumers who had difficulty paying a bill or expense, the average cost of that difficulty tended to exceed the amount of liquidity available immediately to them from savings and credit cards.

Many consumers who experienced difficulty paying a bill or expense use AFS as part of their overall strategy for dealing with the difficulty. Among consumers who experienced difficulty paying a bill or expense, 50 percent borrowed money either using formal or informal credit and,

[3] Consumers largely used their economic impact payments for saving or paying down debt. See: Olivier Coibion, Yuriy Gorodnichenko, and Michael Weber, "How Did U.S. Consumers Use Their Stimulus Payments?" August 2020, NBER Working Paper No. 27693. Available: https://www.nber.org/papers/w27693. On trends in saving and spending and government transfers, see: Josh Mitchell, "U.S. Household Income, Savings Rose at End of Last Year," January 29, 2021, *The Wall Street Journal*. Available: https://www.wsj.com/articles/consumer-spending-personal-income-coronavirus-december-2020-11611873351. On credit card debt, see: Ryan Sandler and Judith Ricks, "The Early Effects of the COVID-19 Pandemic on Consumer Credit," August 2020. Available: https://files.consumerfinance.gov/f/documents/cfpb_early-effects-covid-19-consumer-credit_issue-brief.pdf. On pawn loans, see: Emily Stuart, "It's easy to assume pawnshops are doing great in the pandemic. It's also wrong. It's not just about the guns and gold: Loans are at the core of the pawn business," *Vox*, November 30, 2020. Available: https://www.vox.com/the-goods/21611583/pawn-shop-covid-19-economy. On payday loans, see: Veritec Solution "Update: COVID-19 Impact Study on Small-Dollar Lending," October 22, 2020. Available: https://www.veritecs.com/update-covid-19-impact-study-on-small-dollar-lending/

of those who borrowed, 21 percent turned to an AFS in order to pay for the expense. Using the Making Ends Meet survey, we find that for AFS users, speed, discretion, and the lack of a credit check were important for deciding on their credit source.

Many AFS users appear to have few other credit options while others have significant alternative sources of credit. A majority of AFS users have poor or very poor credit scores and are often turned down for mainstream credit or not granted the full requested amount. Yet a significant portion of consumers using these services had $300 or more in available credit card credit at about the same time they owed money on one of these loans. Using the association with the credit bureau data, we find 28 percent of consumers who owed money on a payday loan when they took the survey had at least $300 in available credit card credit at the end of June 2019. For auto title borrowers, 33 percent had $300 in available credit, while 16 percent of pawn borrowers had $300 in available credit. Other research has reached similar conclusions.[4]

This finding presents a significant puzzle. The interest rate for credit cards is typically much lower than for AFS.[5] Why do so many consumers not use their credit card for liquidity instead of these high-cost loans?

We explore two possibilities. First, we show that AFS users describe themselves as less likely to shop for the best terms. Perhaps consumers who shop less for the best terms find the convenience of an AFS more compelling or are less likely to be aware of the cost differential. Yet in the very small sample, the AFS users who have available credit card credit are more likely to say they search for the best terms, compared to AFS users without available credit card credit, offering suggestive evidence that shopping among these borrowers is not the explanation.

Second, we examine income and expenditure shocks that trigger difficulties for consumers to pay bills and expenses. These shocks tend to be larger than other available credit or savings sources. AFS users who experience difficulty paying a bill or expense tend to also use other available credit, suggesting that for some consumers AFS might be part of a broader and more

4 Sumit Agarwal, Paige Marta Skiba and Jeremy Tobacman, "Payday Loans and Credit Cards: New Liquidity and Credit Scoring Puzzles?" 2009, *American Economic Review*, 99(2):412-17.

5 The average APR on revolving credit cards assessed interest was 16.04 percent in 2019 according to the G.19 Federal Reserve Statistical Release (February 2021). Available: https://www.federalreserve.gov/releases/g19/current/. Meanwhile, the average payday rate is much higher. AFS users typically have lower credit scores (see Figure 10), so would typically be charged a higher rate. The average "effective interest rate" for subprime and deep subprime borrowers was approximately 21 percent in 2018. See: Consumer Financial Protection Bureau, "The Consumer Credit Card Market," August 2019, p. 55. Available: https://files.consumerfinance.gov/f/documents/cfpb_consumer-credit-card-market-report_2019.pdf. Meanwhile, a fee of $15 for every $100 dollars borrowed for a two-week loan caries an APR equivalent of nearly 400 percent. See: https://www.consumerfinance.gov/ask-cfpb/what-are-the-costs-and-fees-for-a-payday-loan-en-1589/.

complicated debt portfolio to deal with difficulties. Understanding the tradeoffs among different ways of dealing with financial difficulties is an important direction for future research.

The Making Ends Meet Survey

We use the first two waves of the Making Ends Meet survey. The survey results provide a deeper understanding of how often U.S. consumers have difficulty making ends meet, how they cope with these shortfalls, and the consequences of the shortfalls. The Bureau conducted Wave 1 of the survey starting in May 2019 and Wave 2 starting in May 2020. Most respondents took several weeks to respond, so typical responses occurred in June in each year. We refer to June as the month the surveys occurred in this brief.

The Wave 2 sample consisted of all respondents, including partial respondents to Wave 1. Repeated surveying of the same consumers allows us to examine how the same individuals' economic circumstances changed and how they react to those changes. Ultimately, 2,990 consumers responded to Wave 1 either on paper or online. Of those, 1,834—or about 61 percent—responded to at least the first questions in Wave 2.

The survey sample is drawn from the Bureau's Consumer Credit Panel (CCP), a comprehensive, national, 1-in-48 sample of credit records maintained by one of the three nationwide consumer reporting agencies.[6] The Wave 1 survey oversampled consumers with lower credit scores, with recent credit delinquencies, and those living in rural areas to help give enough representation to allow analyses among these smaller groups. Using the CCP strengthens the survey by allowing this kind of oversampling.

The Making Ends Meet sample frame will generally not capture AFS users who do not appear in traditional credit bureau data. Therefore, one limitation of the study is that while it is generally representative of individuals with a record at a nationwide consumer reporting agency these consumers may differ from individuals without such a credit record in important ways. In the FDIC survey, for example, pawn use was more common among unbanked households.[7] On the other hand, because the Making Ends Meet survey oversamples among consumers with

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[6] The CCP excludes any information that might reveal consumers' identities, such as names, addresses, and Social Security numbers. For more information on the privacy protections associated with this survey, see the Consumer Experience Research Privacy Impact Assessment. Available:http://files.consumerfinance.gov/f/201406_cfpb_consumer-experience-research_pia.pdf and System of Records Notice CFPB.022, Market and Consumer Research Records. Available: http://www.consumerfinance.gov/privacy/system-records-notices/market-and-consumer-research-records-2/.

[7] Federal Deposit Insurance Corporation, "How America Banks: Household Use of Banking and Financial Services: 2019 FDIC Survey," October 2020, at 48. Available: https://economicinclusion.gov/downloads/2019_FDIC_Unbanked_HH_Survey_Report.pdf.

delinquencies and low credit scores, it may have more precise estimates for these consumers than surveys without the ability to oversample effectively. For simplicity, we refer to consumers in this study with this caveat in mind.

All the results in this report use survey weights to align with the CCP. We use two different sets of weights, depending on the analysis. For analysis only from Wave 1, we use Wave 1 weights. These weights adjust for non-response to the survey using characteristics observable in the CCP for both responders and non-responders.[8]

When we examine both Wave 1 and Wave 2 and transitions between them, we use Wave 2 weights. These weights adjust for the additional attrition between waves. Because the survey sample is drawn from the CCP, we can observe changes in the financial status of both respondents and non-respondents and use those changes in developing weights that adjust for attrition between Wave 1 and Wave 2. The ability to adjust for attrition between Wave 1 and Wave 2, using not just Wave 1 variables, but also observable changes in the CCP between Wave 1 and Wave 2, is another key advantage of the survey and makes the survey results generally reflect the range of consumers' experiences since Wave 1.[9]

Share using Alternative Financial Services

In Figure 1, 4.4 percent of consumers had taken out a payday loan in the six months prior to June 2019, 2.0 percent had taken out an auto title loan, and 2.5 percent had taken out a pawn loan. To help respondents determine whether they had used the service, the survey included a short definition with the question. The survey defined a payday loan as "a loan that you must repay, make a payment on, or rollover on your next payday." This definition might include single-payment payday loans and newer payday installment loans that are payable over time, although depending on the marketing a respondent might not consider these loans to be "payday loans." These installment loans have become more common.[10]

[8] See the initial Making Ends Meet report for a more detailed discussion of Wave 1 weights: Scott Fulford and Marie Rush, "Insights from the Making Ends Meet Survey," July 13, 2020, CFPB Office of Research, Research Brief No 2020-1. Available: https://www.consumerfinance.gov/documents/8990/cfpb_making-ends-meet_survey-results_2020-07.pdf.

[9] See the report on Wave 2 for a more detailed discussion of Wave 2 weights: Scott Fulford, Marie Rush, and Eric Wilson, "Changes in consumer financial status during the early months of the pandemic," April 30, 2021, CFPB Office of Research, Data Point No 2021-2. Available: https://files.consumerfinance.gov/f/documents/cfpb_making-ends-meet_survey-results_2020-07.pdf

[10] Caroline Malone and Paige Marta Skiba, "Installment Loans," December 2, 2019, Vanderbilt Law Research Paper No. 20-04, Available: https://ssrn.com/abstract=3497095 or http://dx.doi.org/10.2139/ssrn.3497095.

FIGURE 1: PERCENT OF CONSUMERS THAT HAD TAKEN OUT THIS TYPE OF LOAN IN SIX MONTHS PRIOR TO JUNE 2019

These shares are broadly similar in magnitude to the shares found in other studies. Respondents to the 2019 FDIC Survey of Household Use of Banking and Financial Services were asked whether they had used payday, auto title or pawn loans in the previous 12 months.[11] For all households in the FDIC survey, 1.3 percent used payday, 0.9 percent used auto title, and 1.3 percent pawn loans. Because relatively few people use payday, auto title, or pawn loans, the estimates in both Making Ends Meet and the FDIC survey are subject to some survey uncertainty. The 95 percent confidence intervals for estimates of these services in Making Ends Meet include approximately two percentage points on either side, so the FDIC estimates, though consistently lower, are typically within the 95 percent confidence interval. One reason for the difference in estimates for payday loans specifically may also be that the Making Ends Meet survey defines these loans, while the FDIC survey does not, so more Making Ends Meet respondents may consider their loan as a payday loan.[12]

Figure 2 shows the percent of the population who had taken out a payday, auto title, or pawn loan in the 12 months prior to June 2020. Because the second wave came approximately 12 months after the first wave, we asked about using these services during the prior year, not the previous six months as in Wave 1. The questions are thus not fully comparable between waves.

[11] Federal Deposit Insurance Corporation, "How America Banks: Household Use of Banking and Financial Services: 2019 FDIC Survey," October 2020. Available: https://economicinclusion.gov/downloads/2019_FDIC_Unbanked_HH_Survey_Report.pdf.

[12] See the FDIC survey instrument. Available: https://www.economicinclusion.gov/downloads/instrument_2019.pdf.

Figure 2 shows that, while the recall period doubled, the share using these products increased somewhat less.

FIGURE 2: PERCENT OF POPULATION THAT HAS TAKEN OUT THIS TYPE OF LOAN IN 12 MONTHS PRIOR TO JUNE 2020

Who uses Alternative Financial Services?

Using the first wave of the survey, Table 1 depicts the characteristics of consumers who have used at least one form of AFS in the six months preceding June 2019. Approximately eight percent of consumers used one of these products. Comparing characteristics of consumers who used AFS and those who did not reveals some key differences. AFS users are more concentrated among the age group between 40-61, consumers with at most a high school degree, Black and Hispanic consumers, low-income consumers, and women. However, as depicted in Table 1 below, AFS users can be found across a diverse spectrum of characteristics in the population and are not limited to these consumer groups. We do not observe substantial changes in characteristics during the second wave of the survey in June 2020, despite this period covering several months of the coronavirus pandemic.

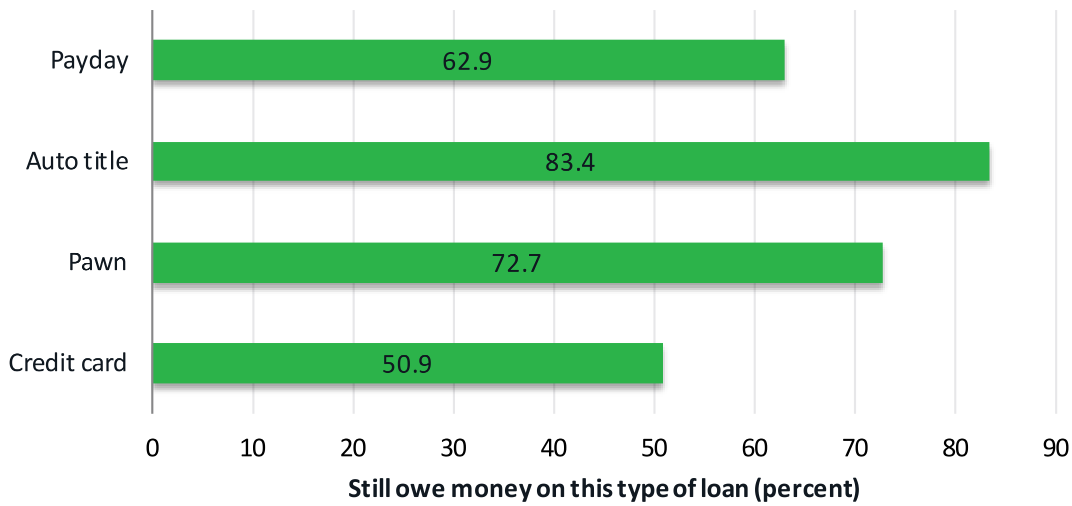
TABLE 1: DEMOGRAPHIC CHARACTERISTICS OF AFS AND NON-AFS USERS IN JUNE 2019, PERCENT OF POPULATION IN EACH GROUP.

Group	Non-AFS users	AFS users
Age group		
Age < 40	32	29
Age 40-61	38	52
Age>=62	31	19
Children in household		
Yes, children in household	39	47
Education group		
At most HS degree	44	68
Technical or 2-year degree	16	18
At least 4-year degree	41	14
Race and ethnicity		
White	69	48
Black	12	32
Hispanic	11	15
Gender		
Male	50	40
Household income		
$15,000 or less	9	21
$15,001 to $20,000	7	13
$20,001 to $40,000	18	27
$40,001 to $70,000	25	23
$70,001 to $100,000	19	8
More than $100,000	23	8
Rural		
Yes, in a rural area	4	3
Overall weighted share of sample	90	10
Observations	**2,628**	**258**

Rollover and repeat borrowing

For the consumers who use these services, borrowing repeatedly or rolling over is very common. While the terms vary, payday, auto title, and pawn loans are typically for 30 days or fewer. Given the short-term nature of these loans, if a consumer took out a loan in the previous six months and still owes money on that type of loan, the consumer is likely to have rolled over the loan or taken out a new loan. Figure 3 shows that, among consumers who had taken out a payday loan in the previous six months to June 2019, 63 percent still owed money on a payday loan at the time of the survey; for auto title loans, 83 percent still owed money; and pawnshop loans 73 percent still owed money. Some forms of auto title and pawn loans can be longer than 30 days which may explain why many consumers still owe money on a loan taken out within the last six months.

FIGURE 3: PERCENT OF POPULATION THAT STILL OWED MONEY ON THIS TYPE OF LOAN, IF HAD TAKEN ONE OUT IN SIX MONTHS PRIOR TO JUNE 2019



For payday loans, respondents were asked directly about rolling over loans. In the survey, 48 percent of consumers who had taken out a payday loan in the previous six months had rolled over at least one payday loan in the previous six months.

For comparison, consumers roll over other types of loans frequently as well: 51 percent of consumers with a credit card did not pay the full bill in the previous month in June 2019. In the survey, 79 percent of consumers had a credit card.

Previous research has also found that rolling over payday loans or borrowing a new loan within a short period of time is very common. For example, a 2014 Bureau study of all payday loans extended by several lenders over a period of at least 12 months found that 80 percent of payday loans are rolled over or followed by another loan within 14 days.[13] Making Ends Meet is a survey of consumers not a data set of accounts, so it offers a slightly different perspective. This different perspective makes it difficult to compare whether rollover patterns have changed compared to account-level studies. For example, some consumers may not consider taking out a new loan soon after paying back an old loan a "rollover" and the survey did not define the term for

[13] Kathleen Burke, Jonathan Lanning, Jesse Leary, Jialan Wang, "Payday Lending," March 2014, The CFPB Office of Research, Data Point. Available: https://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf.

respondents. Other recent work surveying consumers when they took out a payday loan finds that 74 percent borrowed again within eight weeks.[14]

Because of the disruptions of the pandemic, the use of these services may have changed. For example, while unemployment increased, the CARES Act provided substantial increases in unemployment benefits and one-time Economic Impact Payments. Together with reductions in spending, these transfers contributed to improvements in average consumer financial status during the first several months of the pandemic[15] and to a fall in credit card debt,[16] even for the most financially vulnerable consumers.[17] Reports from interviews with pawn shop owners and operators suggest that many patrons used their newfound liquidity to redeem longstanding loans.[18]

Figure 4 suggests that AFS use changed during the initial months of the pandemic. Figure 4 shows that consumers were much less likely to still owe money on payday and pawn loans, conditional on having taken one out in the previous 12 months. The fall in pawn loans was particularly dramatic, more than halving from 73 to 34 percent. However, the change in the recall period from six to twelve months may be responsible for some of this change. A consumer who took out a loan more than six months ago may be less likely to still owe money on that type of loan. Meanwhile, more than 80 percent of consumers who had taken out an auto title loan still owed money and 51 percent of consumers were revolving credit card debt, the same percentage as in June 2019.

[14] Hunt Allcott, Joshua Kim, Dmitry Taubinsky, and Jonathan Zinman, "Are High-Interest Loans Predatory? Theory and Evidence from Payday Lending" February 2021, working paper. Available: https://cpb-us-e1.wpmucdn.com/sites.dartmouth.edu/dist/6/1996/files/2021/02/Payday.pdf

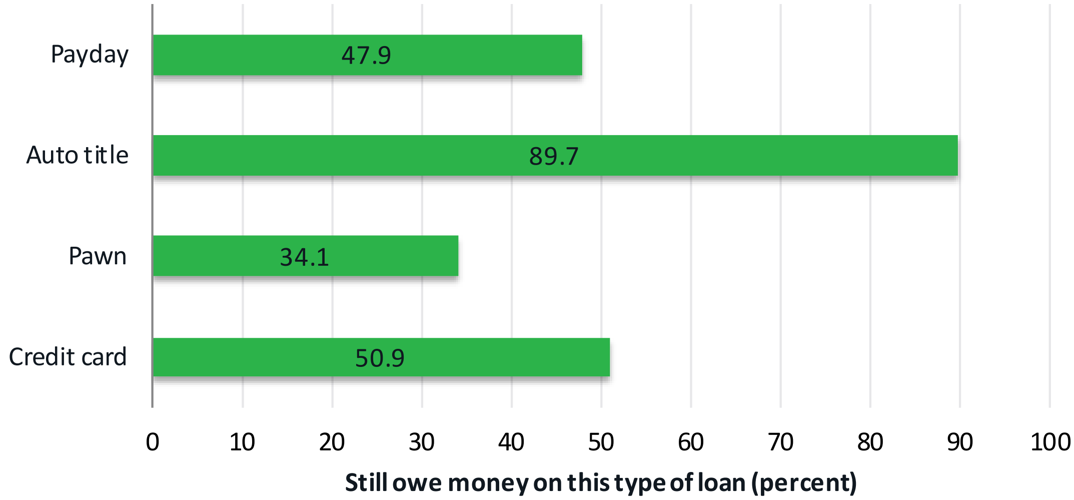
[15] Scott Fulford, Marie Rush and Eric Wilson, "Changes in consumer financial status during the early months of the pandemic," April 2021.

[16] Sandler and Ricks, "The Early Effects of the COVID-19 Pandemic on Consumer Credit."

[17] Scott Fulford and Marie Rush, "Credit card debt fell even for consumers who were having financial difficulties before the pandemic", December 17, 2020. Available: https://www.consumerfinance.gov/about-us/blog/credit-card-debt-fell-even-consumers-having-financial-difficulties-before-pandemic/

[18] Emily Stuart, "It's easy to assume pawnshops are doing great in the pandemic. It's also wrong. It's not just about the guns and gold: Loans are at the core of the pawn business," *Vox*, November 30, 2020. Available: https://www.vox.com/the-goods/21611583/pawn-shop-covid-19-economy.

FIGURE 4: PERCENT OF POPULATION THAT STILL OWED MONEY ON THIS TYPE OF LOAN, IF HAVE TAKEN ONE OUT IN 12 MONTHS PRIOR TO JUNE 2020 (PERCENT)



Persistence of use

The previous section showed a snapshot of use in the two waves. This section examines the transitions into and out of using these products for the same consumers across the two waves.

Figure 5 shows the transitions into and out of using payday from the two waves of the survey. The upper bar shows that 52 percent of consumers who took out a payday loan in the six months preceding June 2019 had borrowed at least one payday loan between June 2019 and June 2020. Payday use is thus quite persistent. The bottom bar is for consumers who did not take out a payday loan in the six months before June 2019. Of these consumers, only 3.5 percent newly took out a payday loan between June 2019 and June 2020.

FIGURE 5: TRANSITION INTO AND OUT OF PAYDAY USE FROM JUNE 2019 TO JUNE 2020 (PERCENT)

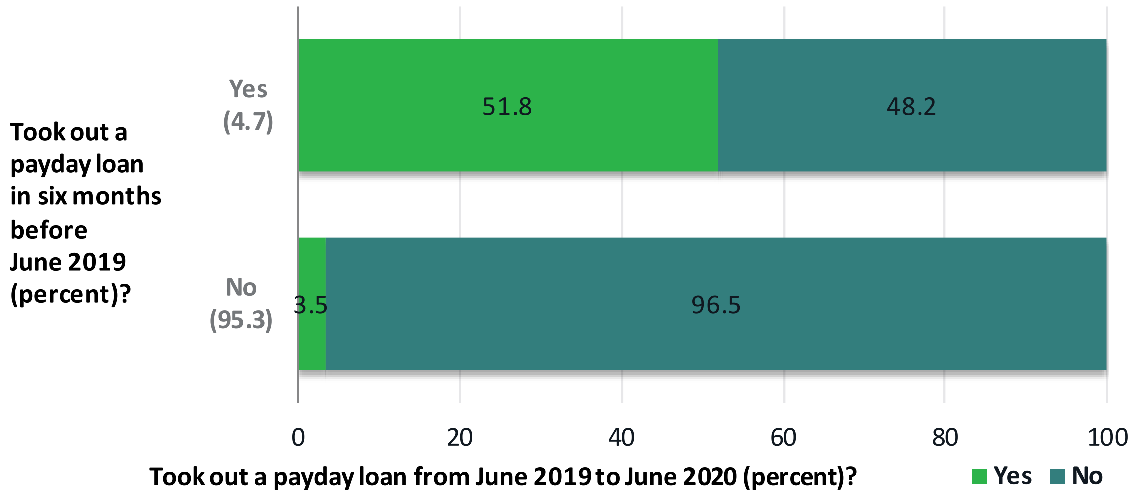


Figure 6 shows a similar transition for auto title use, which is also persistent. In June 2020, 32.1 percent of the consumers who had taken out an auto title loan in the six months before June 2019 had also taken out an auto title loan in the 12 months before June 2020. Only 2.2 percent of consumers who were not using auto title loans in the six months to June 2019 were newly using auto title loans between June 2019 and June 2020.

FIGURE 6: TRANSITION INTO AND OUT OF AUTO TITLE LOAN USE FROM JUNE 2019 TO JUNE 2020 (PERCENT)

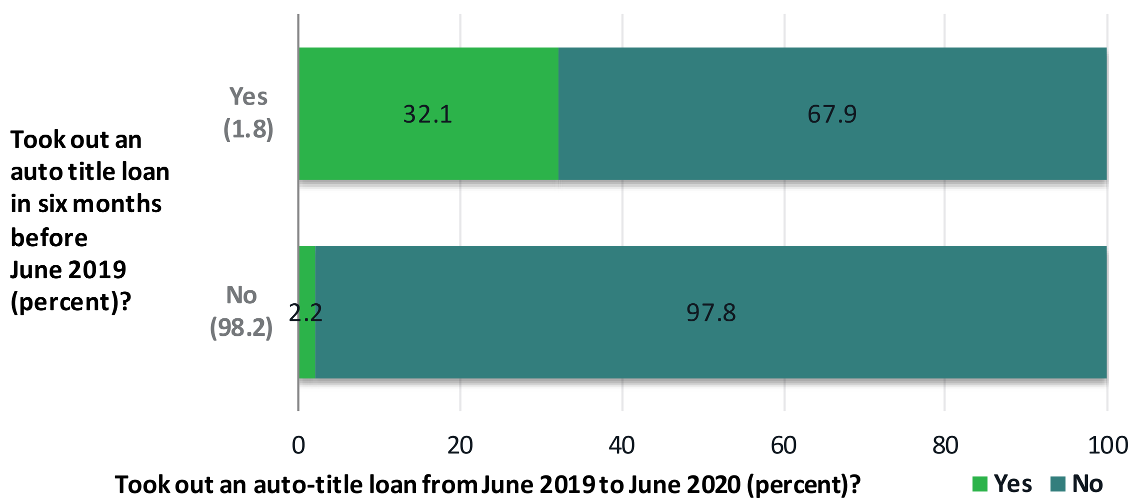
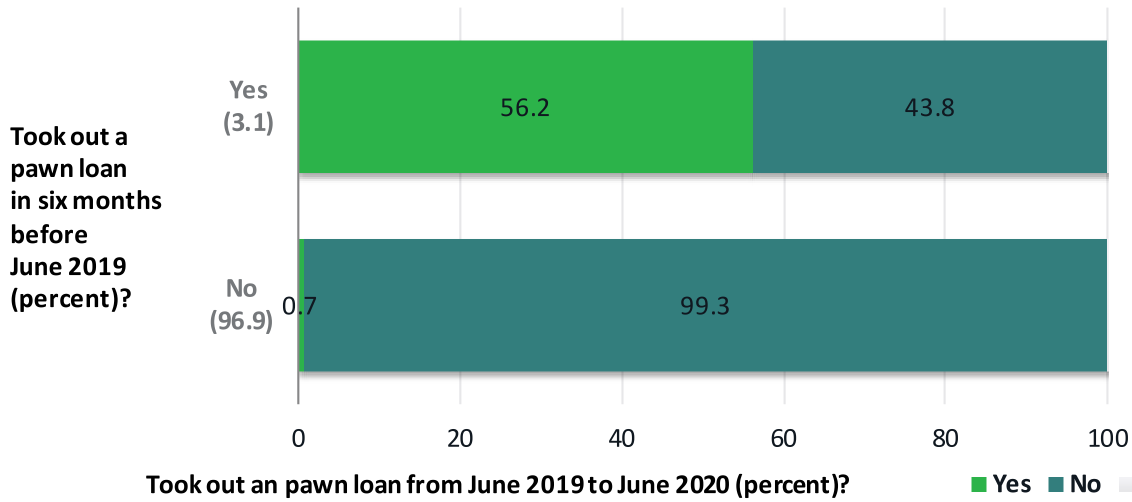


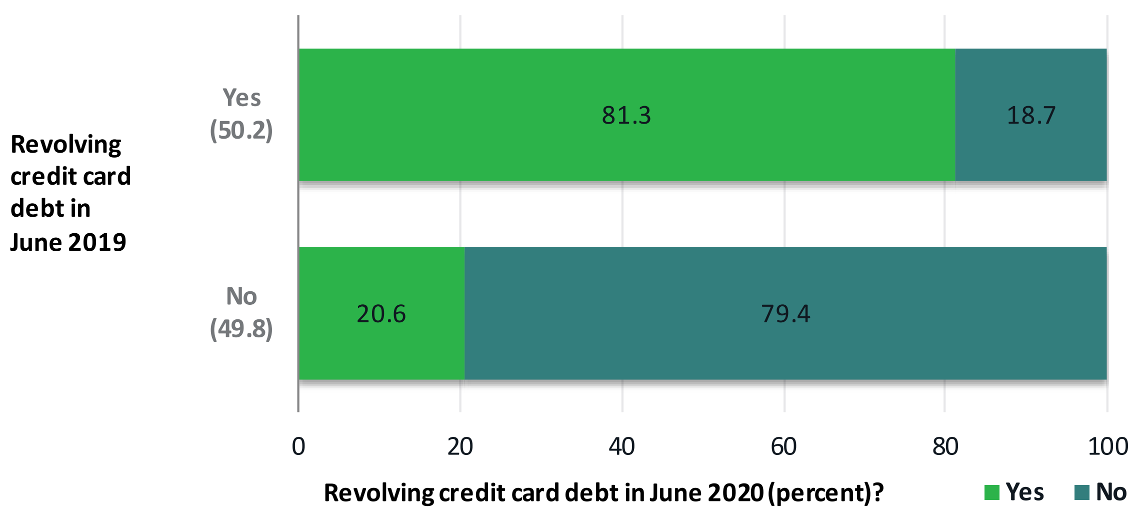
Figure 7 shows the transition for pawn loan use. In June 2020, 56 percent of the consumers who had taken out a pawn loan in the six months before June 2019 had also taken out a pawn loan in the 12 months before June 2020. Only 0.7 percent of consumers who were not using pawn loans in the six months before June 2019 were newly using pawn loans between June 2019 and June 2020.

FIGURE 7: TRANSITION INTO AND OUT OF PAWN LOAN USE FROM JUNE 2019 TO JUNE 2020 (PERCENT)



For comparison, Figure 8 shows the transition into and out of revolving credit card debt. In June 2020, 81 percent of consumers who were revolving credit card debt in June 2019 were still revolving. Meanwhile, 21 percent of consumers who were not revolving in June 2019 had started by June 2020.

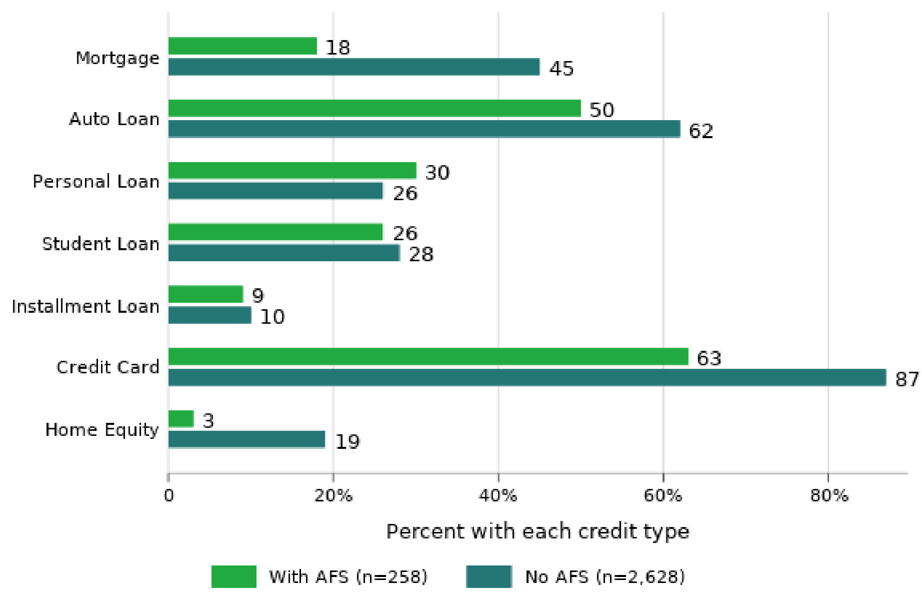
FIGURE 8: TRANSITION INTO AND OUT OF REVOLVING CREDIT CARD USE FROM JUNE 2019 TO JUNE 2020 (PERCENT)



Is lower-cost credit available?

The connection to the CCP allows us to examine whether the users of these services also use more traditional forms of credit and whether they have other available credit. Figure 9 displays the percent of AFS users in June 2019 who also have other types of credit, compared to the percent among AFS non-users. Compared to consumers who do not use any type of AFS, AFS users are much less likely to have a mortgage or home equity product. While the share of AFS users with a credit card is lower than non-AFS users, 63 percent do have an active credit card.

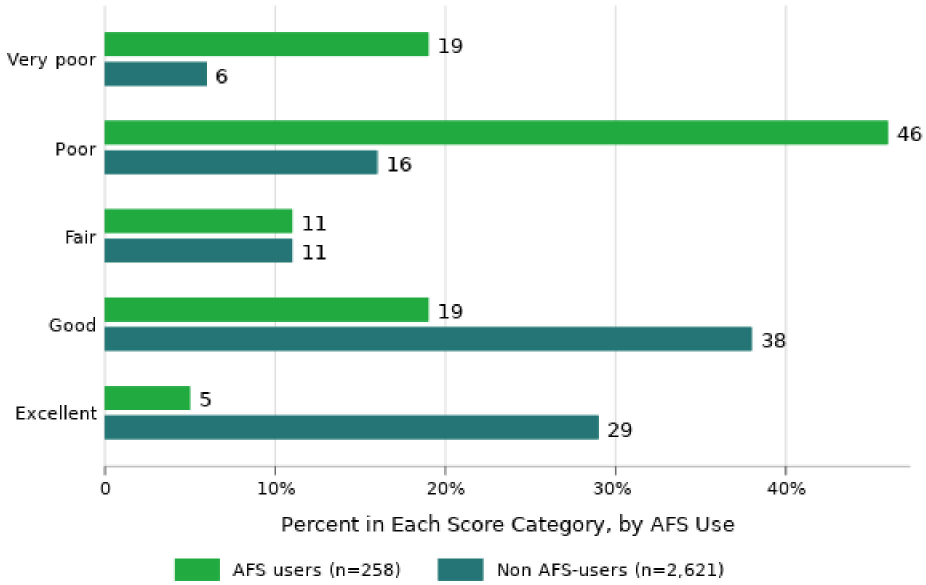
FIGURE 9: FORMAL CREDIT USE AMONG CONSUMERS WHO USE AND DO NOT USE AFS (JUNE 2019)



Poor credit may hinder some AFS users from accessing formal credit products with more favorable terms. The survey's association with credit bureau data allows us to observe respondent's credit score in addition to other traditional credit usage. Figure 10 shows the distribution of Vantage credit scores by broad credit score category for consumers with and without AFS use.[19] Over 60 percent of AFS users have credit scores that are either poor or very poor. Still, 24 percent have scores considered good or excellent which might allow them to access other sources of credit.

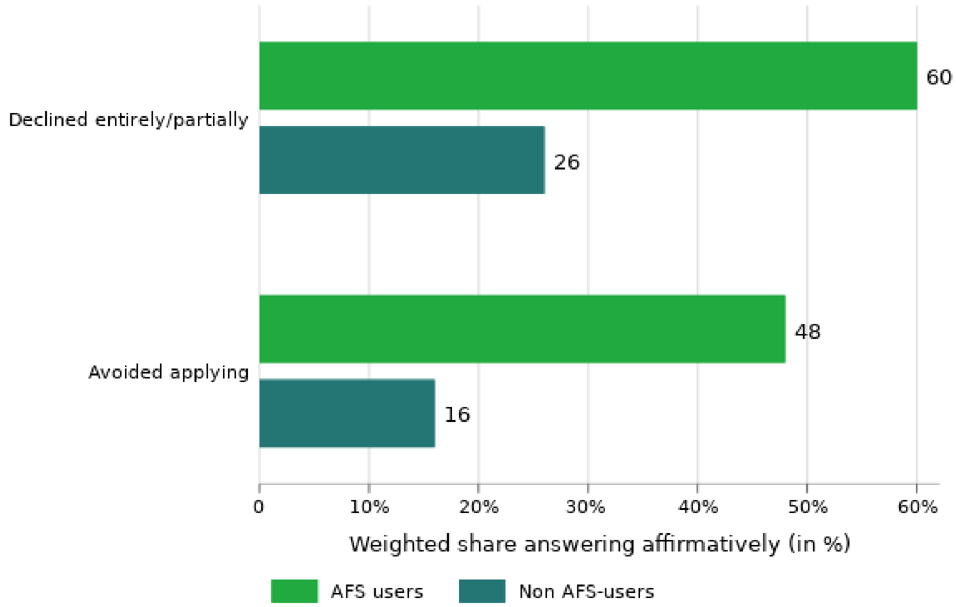
[19] We use standard scoring categories of: Excellent 781-850, Good 661-780, Fair 601-660, Poor 500-600, and Very Poor 300-499. See: Louis DeNicola, "What is a Good Credit Score," February 11, 2021, Experian Blog. Available: https://www.experian.com/blogs/ask-experian/credit-education/score-basics/what-is-a-good-credit-score/#s2.

FIGURE 10: VANTAGE CREDIT SCORES BY AFS USE



Consumers using AFS not only have less favorable credit scores; they also are more likely to have applied for credit in the past year (59 percent compared to 40 percent among non-AFS users) and are more likely to have been turned down outright or have their credit application accepted for a lower amount than they requested. Figure 11 documents that, conditional on having applied for credit in the previous 12 months, 60 percent of AFS users were turned down or only granted a limited amount of credit compared to only 26 percent of consumers without AFS usage. Furthermore, 48 percent of AFS users who did not apply for credit in the past year reported that they did not do so because they anticipated having their application rejected. In all, this means about 55 percent of AFS borrowers were unable to access additional credit they wanted because they were denied or expected they would be.

FIGURE 11: PERCENT OF CONSUMERS TURNED DOWN FOR CREDIT OR WHO DID NOT APPLY BECAUSE THEY THOUGHT THEY MIGHT BE TURNED DOWN



Among the 63 percent of AFS users who also have a credit card, we use data from the CCP to take a deeper look at the amount of available credit they have on these cards. The issuers of credit cards typically report to the credit bureau the credit limit and the amount owed, which may include both revolving debt and new debt from purchases over the previous month. Summing across all credit cards, we determine whether a consumer in the survey had at least $300 in available credit in June 2019 by subtracting the total credit card debt from the sum of the credit limit on all cards. Consumers with $300 in available credit card credit might have been able to use a cash advance instead of an AFS or could have paid for some consumption with a credit card and left funds available to pay off a payday, auto title, or pawn shop loan. We use $300 because it is approximately the size of a standard payday loan. We observe the credit limit and debt for a consumer typically as of their last billing cycle at the end of June 2019 but observe whether the respondent owed money at the time of the survey. While the timing closely aligns, it is possible that circumstances may have changed between answering the survey and the close of the credit card billing cycle.

Figure 12 shows the proportion of consumers who: (1) reported taking out a loan in the previous six months and still owe money on a loan of that type and (2) likely had $300 in available credit card credit. Figure 12 also shows the share of consumers who still owe money and have a credit card in June 2019. In the survey, 28 percent of current payday borrowers had $300 in available credit card credit reported in June 2019, as did 33 percent of auto title borrowers, and 16 percent of pawn borrowers. Pawn users are much less likely to have a credit card and to have a least $300 in available credit.

FIGURE 12: PERCENT OF CONSUMERS WHO STILL OWE MONEY ON A PAYDAY, AUTO TITLE, AND PAWN LOAN WHO HAVE AT LEAST $300 IN AVAILABLE CREDIT CARD CREDIT

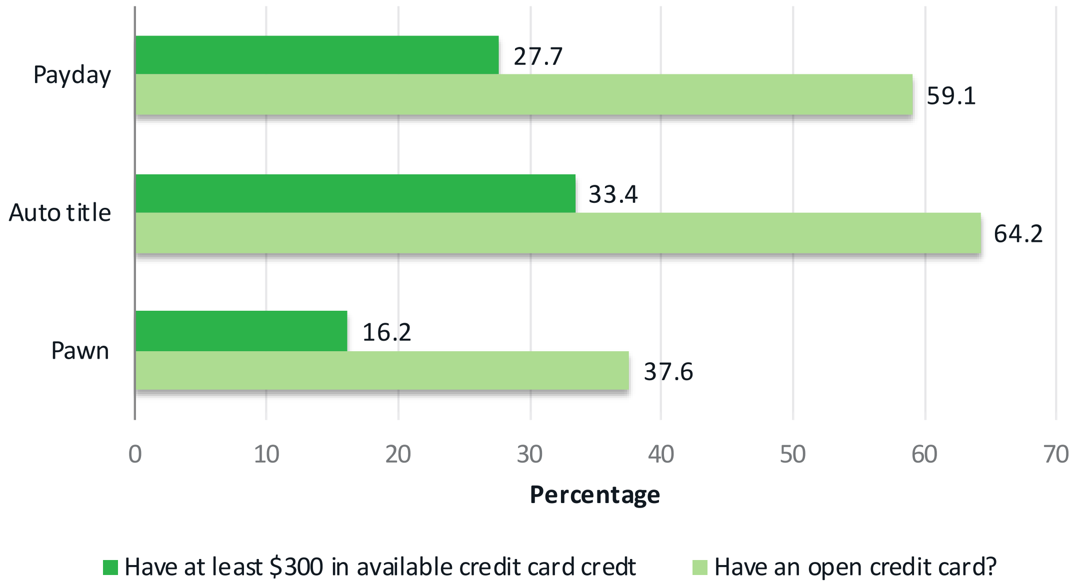


Figure 12 presents a credit card puzzle. Why do consumers choose very high-cost borrowing when a much lower cost product is available? We focus on consumers who report still owing money on a high-cost loan so that the timing aligns as closely as possible; consumers who still owe money on a loan and have available credit card credit may have the option to substitute between these products. There may be some difficulty in substituting between products, which may explain the behavior for some consumers. For example, switching between products might require a credit card cash advance to pay off the loan directly, which may not always be possible. Yet it is hard to imagine that the precautionary concerns for why some consumers may keep both cash and credit card credit available would be sufficient to overcome the interest differential between payday and credit cards.[20] Alternatively, consumers may not realize that credit cards are less expensive or have other reasons to prefer AFS.[21]

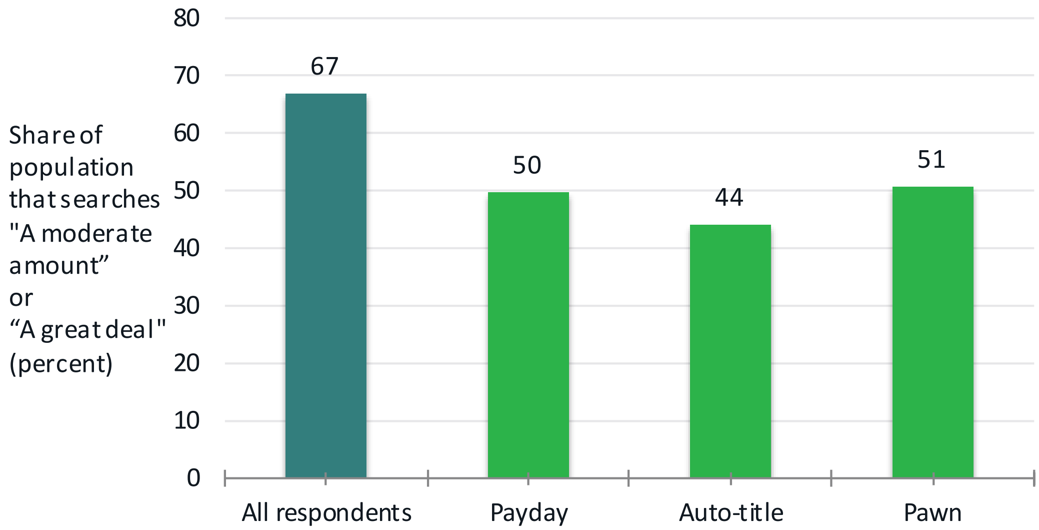
Users of AFS are less likely to search for the best terms, but this pattern does not seem to explain the puzzle. We asked survey respondents: "When making major decisions about borrowing money or getting credit, some people search for the best terms while others don't. Which of the following comes closest to describing how much you search when borrowing or

[20] See: Scott L. Fulford, "How important is variability in consumer credit limits?" 2015, *Journal of Monetary Economics* 72: 42-63.

[21] Nathalie Martin, "1,000% Interest- Good While Supplies Last: A Study of Payday Loan Practices and Solutions," 2010, *Arizona Law Review* 52(3). Available: https://digitalrepository.unm.edu/law_facultyscholarship/28.

getting credit?" giving them four options: "Not at all," "A little," "A moderate amount," "A great deal."

FIGURE 13: PERCENT OF CONSUMERS THAT SEARCH "A MODERATE AMOUNT" OR A "A GREAT DEAL"



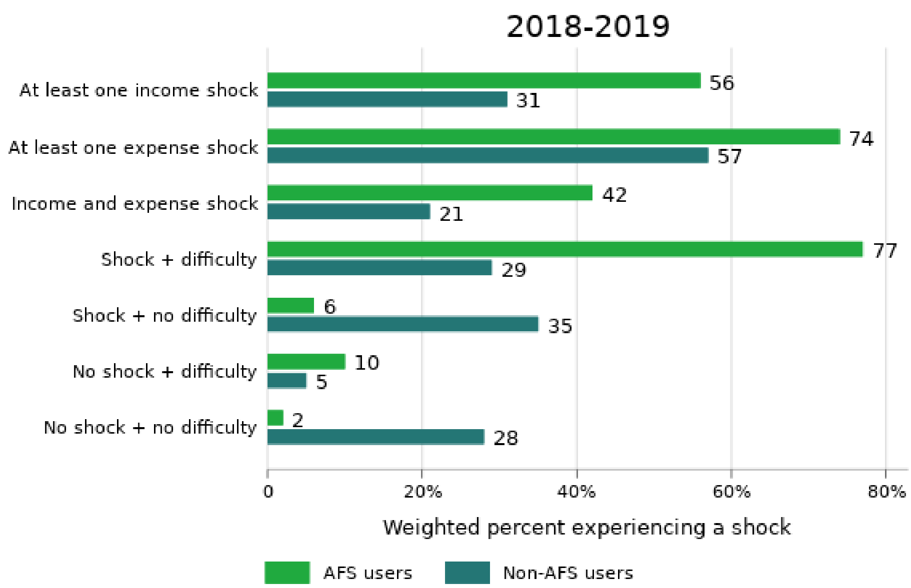
Payday, auto title, and pawn users all report that they shop with less intensity than the average consumer. Figure 13 shows the share of high-cost borrowers and all survey respondents who answered: "A moderate amount" or "A great deal." In Figure 13, someone is a user if they took out a loan in the six months before June 2019. When we restricted to users who also had at least $300 in available credit card credit, however, this very small number of borrowers was more likely to report they shop intensively.

Shocks and AFS use

Consumers who turn to alternative financial services for credit may do so because of various income or expense shocks. In the Making Ends Meet survey, respondents were asked whether they had "difficulty paying a bill or expense" in the previous 12 months. Figure 14 displays the shock experiences of each consumer group using responses to questions about a range of shocks from Wave 1 in June 2019. We focus on Wave 1 to better understand AFS use during the pre-pandemic period and because the sample is bigger. Income shocks include loss of income from illness, job loss or hours reductions, loss of government benefits, or other unspecified forms of income loss. Expense shocks include medical expenses, home or auto repairs, taxes or fees, legal bills, and death or funeral costs.

Consumers reporting using alternative financial services in the previous year are much more likely to also report having experienced an income or expense shock in that same year. While a majority of consumers experienced at least one expense shock in the previous year, many more AFS users did so (74 percent compared to 57 percent of non-AFS users). In June 2019, 40 percent of all consumers reported having had difficulty paying a bill or expense in the previous 12 months.[22] Among AFS users, 77 percent had both a shock and difficulties paying a bill or expense. Another 10 percent of AFS users had difficulties paying a bill or an expense even in the absence of a reported adverse shock.

FIGURE 14: CONSUMER EXPERIENCES WITH INCOME AND EXPENDITURE SHOCKS BY AFS USE

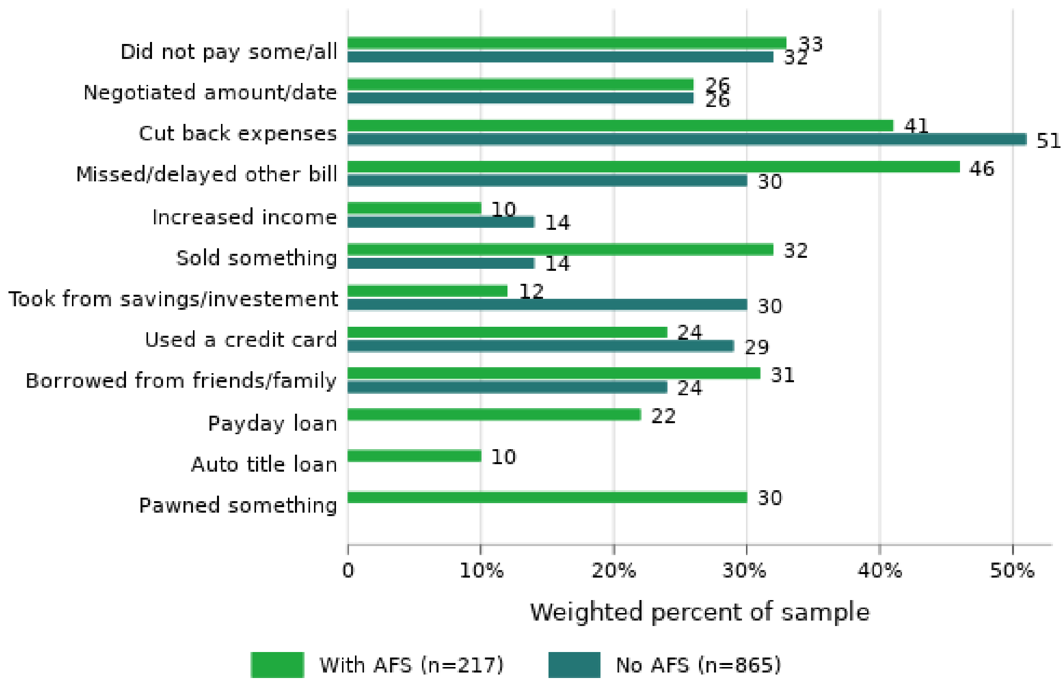


Next, we examine how consumers with and without AFS use reacted to such difficulties. Respondents were asked: "Which of the following did you do when you had difficulty paying that expense?" and given a list of options. Among consumers who experienced difficulty paying a bill or expense, 50 percent borrowed money either using formal or informal credit and, of those who borrowed, 21 percent turned to at least one form of alternative financial services in order to pay for the expense. Figure 15 shows the weighted share of consumers who dealt with having difficulty paying a bill or expense using each approach. The figure compares consumers who used AFS at any time during the previous six months, not necessarily in response to the

[22] Scott Fulford and Marie Rush, "Insights from the Making Ends Meet Survey," July 2020.

difficulty, to non-AFS users. Multiple selections were possible, so the shares sum to more than 100 percent.[23]

FIGURE 15: FOR CONSUMERS WHO HAD DIFFICULTY PAYING A BILL OR EXPENSE: "WHICH OF THE FOLLOWING DID YOU DO WHEN YOU HAD DIFFICULTY PAYING THAT EXPENSE?" BY AFS USE



When faced with difficulty paying a bill or expense, consumers who do and do not use alternative credit were about equally as likely to not pay some or all of the bill (32-33 percent) or to negotiate the amount or timing of the payment (26 percent). Very few consumers borrowed from retirement, used a bank loan, or drew on a home equity line of credit when they had difficulty paying for a bill or expense. Consumers who relied exclusively on formal credit were more likely to cut back on other expenses (51 versus 41 percent) or take money from a savings or investment account (30 versus 12 percent) and less likely to pay a bill at the expense of missing or delaying payment on another bill or expense (30 versus 46 percent). These differences,

[23] In addition to the most common item responses shown in the figure, five percent of both AFS users and non-users borrowed using a bank loan and four percent borrowed from retirement account. Five percent of AFS users and one percent of non-users borrowed from an unlicensed lender. Two percent of AFS users and three percent of non-users borrowed from a HELOC. The percent of the sample using payday, auto title or pawn loans in this figure refers to using this form of credit specifically in response to the last time they had difficulty paying for a bill or expense. By contrast, the AFS-user and non-user groups throughout the paper refer to using one of these forms of credit in the preceding 12 months, irrespective of the reason.

however, could simply be due to higher income and savings amounts among consumers who do not use AFS.

Figure 15 furthermore documents that consumers using AFS employed several additional strategies to make ends meet. In addition to cutting back expenses, negotiating the amount or timing of payment, selling something or borrowing from friends and family, 24 percent of AFS users with difficulty paying bills also used a credit card to pay expenses. However, as Figure 16 shows, the average amount of the expense causing the difficulty among AFS users surpassed the average available liquidity on all credit cards.

Among consumers reporting difficulties paying for a bill or expense, respondents indicated whether an event caused this trouble, and if so, recorded the monetary value of the bill, expense or loss of income from the event. Consumers also reported the amount their household has in checking and savings accounts at the time of the survey.[24] Using additional information in the CCP, it is possible to compare the magnitude of the expense that caused financial difficulty to the consumer's available liquidity in savings, checking and credit cards. Note, however, that respondents were asked about the most recent difficulty, while we measure liquidity at the time of the survey, so the liquidity available at the time of the event may have been different. Figure 16 plots these distributions separately for AFS users and non-users, showing the dollar amount of available funds in credit cards from the CCP and in savings or checking accounts from the survey against the amount of the bill, expense or income loss causing financial difficulty. The left border of each box in the graph represents the value at the 25th percentile and the right border marks that at the 75th percentile. The median value, or that of the average AFS user (or non-AFS user), is demarcated with a diamond. AFS users have substantially less liquidity in checking or savings accounts compared to non-AFS users and also significantly less availability in their combined credit cards. Note that the scale for AFS and non-AFS users are different to accommodate the higher value for non-AFS users.

[24] Consumers report one of the following ranges: $0, less than $100, $100 to $500, $501 to $1,000, $1,001 to $3,000, $3,001 to $5,000, $5,001 to $10,000 or more than $10,000. We use the midpoint in each of these ranges to estimate the dollar amount in savings and checking. For amounts above $10,000, we use $10,000.

FIGURE 16: CARD AVAILABILITY, EXPENSE SHOCKS AND SAVINGS FOR AFS AND NON-AFS BORROWERS

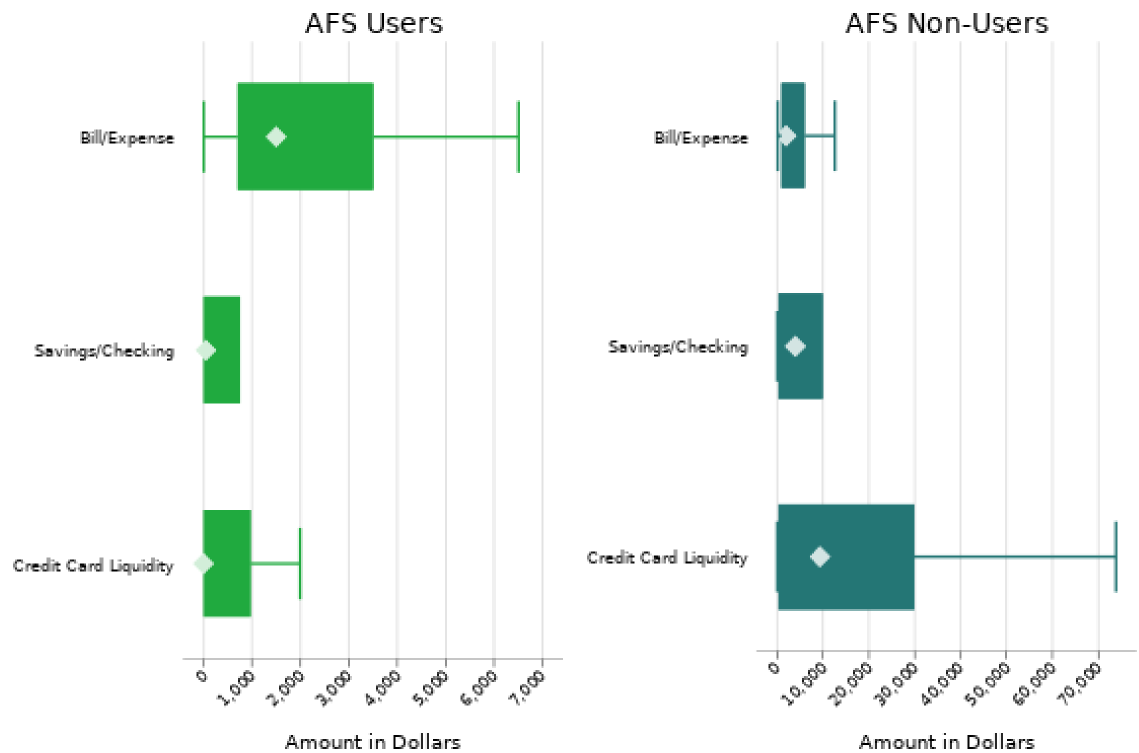
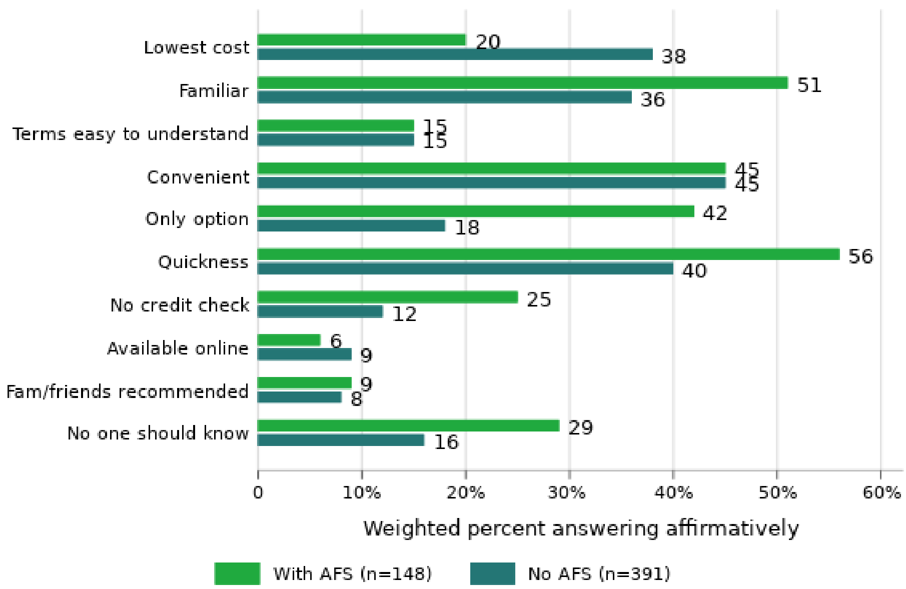


Figure 16 documents that the amount of the bill or expense reported as causing the trouble for the median AFS user is higher than the median combined amount in savings accounts and available on credit cards when the respondent answered the survey. An alternative way to consider the discrepancy between liquidity and expenses is to calculate this difference for each consumer, since the consumer with the median liquidity amount is not necessarily the same consumer with the median expense. At the individual level, we approximate the amount in checking and savings in order to estimate this difference at the consumer level, subtracting the stated expense amount from total credit card and savings liquidity.

Calculated this way, for non-AFS users who report difficulty paying for a bill due to an adverse event, the median amount of funds after paying for the expense would be $435 (and a mean of $7,964). By contrast, AFS users exhibit a median *deficit* of $800 (and a mean deficit of $2,568). Nevertheless, among AFS users, approximately 10 percent of those reporting trouble with expenses due to a negative event have enough liquidity in savings, checking and credit cards to pay for the stated expense without using these higher interest alternative financial products.

Among consumers who borrowed after having difficulty paying a bill or expense in the 12 months preceding the survey, Figure 17 highlights that the speed with which funds are made available and anonymity are key motivators for AFS users in their loan choice. Among AFS users, 56 percent said getting the money quickly was a reason to choose the option. AFS users were also more likely to describe the borrowing method they selected as the only option for which they would qualify (42 percent) and 29 percent said that they did not want anyone to know they needed money.

FIGURE 17: REASONS FOR SELECTING THE GIVEN METHOD OF BORROWING AMONG CONSUMERS WITH TROUBLE PAYING AN EXPENSE



Conclusion

Relatively few consumers use payday, auto title, and pawn loans. But the consumers who do use them tend to use them repeatedly. Around half of users in June 2019 were still using these services in June 2020. More than 60 percent of AFS users have a credit card and around a third of consumers who owed money on a payday and auto title loan in June 2019 had at least $300 in available credit card credit. Yet many AFS users are credit constrained in other ways. AFS users typically have lower credit scores than other consumers and many have applied for credit and been turned down or decided not to apply because they thought they would be turned down. Many AFS users also experience sizable and costly shocks that exceed their available savings and credit card credit.