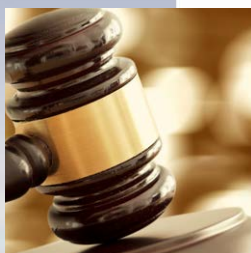
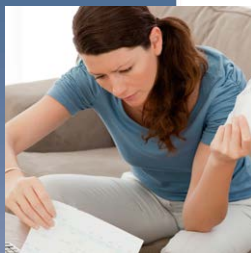


FAIR FINANCING:

Expanding Small-Dollar Short-Term Credit for Albertans



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Ellen M. Dungen, MBA
Randy Coutts, MBA
Rhianon MacDonnell, PhD

March 31, 2016

FAIR FINANCING:

Expanding Small-Dollar Short-Term Credit for Albertans

AUTHORS

Ellen Dungen, MBA

Experience

Ellen is President of EMD Consulting LTD., advising companies on leveraging their corporate competencies to positively impact critical societal needs in ways that provide a measurable return to both the community and the business. With a career spanning more than 30 years in Financial Services, Ellen has held senior leadership positions with three organizations. She holds an MBA from Dalhousie University and certificates in Corporate Citizenship Management and Corporate Community Involvement from Boston College's Carroll School of Management's Center for Corporate Citizenship. She has completed the Canadian Securities Course and Certified Financial Planner designation. Ellen is a Fellow of the Institute of Canadian Bankers

Community Volunteer

Ellen has been a Board Member at United Way of Calgary and Area and sits on the Finance and Audit, Community Impact, and Strategic Planning committees. She also participates in Financial Empowerment Collaborative, part of *Enough for All* -Calgary's Poverty Reduction Strategy.

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Experience

Randy has spent the last decade strengthening communities and counselling entrepreneurs. He works with a variety of financial institutions, advising entrepreneurs and managing risk. His specialties are product design and pricing, risk management, social capital financing methodology/social finance, financial services optimization, and social entrepreneurship. Randy holds an MBA from Dalhousie University.

Community Volunteer

Randy volunteers with a variety of agencies in the poverty reduction and youth engagement fields, including Calgary Bridge Foundation for Youth, Investors Without Borders, and Calgary Marathon Society as volunteer treasurer. His latest passion, working with social entrepreneurs, is where both worlds collide, and while most of his efforts have been focused in Canada, he has recently taken a role with an exciting social enterprise in East Africa.

Rhiannon MacDonnell, PhD

Experience

Rhiannon is CEO and Co-Founder of Verity Common, focusing on implementation research, program evaluation, and impact measurement to provide Boards, senior leaders, and policy-makers with data-driven insights. An Assistant Professor at Cass Business School in London (UK), Rhiannon holds a PhD in Management from the Haskayne School of Business at the University of Calgary, an MSc in Industrial-Organizational Psychology from the University of Calgary, and a Bachelor's degree in Psychology from the University of Waterloo. She also completed a post-doctoral fellowship at the University of Alberta School of Business.

Community Volunteer

Rhiannon is a Board Trustee for the City Centre for Charity Effectiveness Trust at Cass Business School at City University London, which is a leader in Social Finance education for the non-profit sector in the United Kingdom. Rhiannon has served on the Board of Directors of United Way of Calgary and Area and Classroom Champions International, where she conducts the program evaluation and impact research.

ABOUT THIS PAPER

This paper examines small-dollar credit alternatives to the current payday-loan product in the province of Alberta. While we recognize that most people have credit requirements from time to time, the unbanked and underbanked who can least afford to do so are forced to obtain credit under the most unfavorable terms. This needs to change. We believe there is a role to be played by all three levels of government, as well as by investors, philanthropists, financial institutions, community-based lenders, employers, social enterprise and, with modification of the current business model, payday lenders.

Our work builds on significant prior work in the area of financial empowerment and inclusion. We would like to encourage readers of our report to also review the February 2016 report by Cardus entitled *Banking on the Margins: Finding Ways to Build an Enabling Small-Dollar Credit Market*; the Centre for Financial Services Innovation's 2013 report, *Know Your Borrower: The Four Needs Cases of Small-Dollar Credit Consumers*; and the presentation by Policis at the Money Advice Liaison Group's (MALG) annual conference 2015 entitled *The Future of Illegal Lending in the UK: Online, unregulated and coming soon to a market near you?* A complete list of interviewees and references is included in the Appendix.

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Terminology

APR

Annual percentage rate for interest.

Credit Score

This numerical expression is based on a level analysis of a person's credit files, to represent the creditworthiness¹ of the person. A credit score is primarily based on credit report information typically sourced from credit bureaus.

Empowering Small-Dollar Credit

Structuring small-dollar credit in such a way that it enables individuals to address their immediate needs, while at the same time allowing them to build their credit and improve their financial future.

Financial Education

The process of facilitating financial learning, or the acquisition of knowledge, skills, values, beliefs, and habits.

Financial Empowerment

An approach to poverty reduction that focuses on improving the financial security of low-income people.²

Financial Health

The extent to which an individual's day-to-day financial system functions well and increases the likelihood of long-term financial resilience and opportunity.³

Financial Literacy

The knowledge, skills, and confidence needed to make good financial decisions and improve financial well-being.⁴

Low Income

Defined by the Canadian government for 2015 as an individual making less than \$24,600 or a family of four making \$45,712 or less.⁵

Monoline Lenders

Non-deposit-taking lenders; in the case of payday lenders they generate most of their revenue from payday loans.

Patient Debt

Patient capital is another name for long-term capital. With patient capital, the investor is willing to make a financial investment in a business with no expectation of turning a quick profit. Instead, the investor is willing to forgo an immediate return in anticipation of more substantial returns down the road. Similarly, patient debt, as used in this report, describes a product based on the realization that short-term monetary returns may be sacrificed for longer-term social gains.

Payday Loan

This is an unsecured advancement of money with a principal of \$1,500 or less and a term of 62 days or less, usually within 14 days, made in exchange for a post-dated cheque, a pre-authorized debit, or a future payment of a similar nature. To qualify for a payday loan, a customer must be able to provide proof of identity, be employed or have a source of income, and have a bank account.⁶

Predatory Lending

A process, often starting with misleading sales tactics, that culminates in the origination of a loan to a borrower who is paying too much in fees, interest, or insurance, may not fully understand or was not made aware of all the provisions of the contract, and may not have the financial capacity to repay the loan.⁷

Small-Dollar Credit (SDC)

Credit amounts from \$100 to \$5,000 for terms generally less than three years.

Underserved Customers

Unbanked or under-banked customers who are not able to be scored or who have subprime credit scores with low to moderate and/or variable income. Some underserved customers have all three of these characteristics, while others may have only one or two.

Overview

Momentum⁸ has engaged EMD Consulting LTD. to identify fair, scalable, and sustainable alternatives to the current payday-loan product that can be used by individuals to access small-dollar credit when they need it, while empowering them to improve their financial health. Financial empowerment focuses on helping low-income people participate and feel included in the financial system. It increases opportunities and knowledge, and fosters behaviours that are critical to economic security and the ability to invest in the future.⁹

This report is intended to support accelerated innovation and empowering small dollar credit alternatives in the financial services sector. In order to develop empowering alternatives we conducted an international environmental scan of payday loans and payday-loan alternatives, along with an examination of the payday-loan customer, including insights from Canada, the United States, Australia, and the United Kingdom. This analysis brought to light three key myths about payday loans that infringe on our ability to meaningfully move toward creating robust alternatives. Rather, by properly understanding the situation as it is, we are best positioned to develop a strategy that will yield success. These myths are:

Myth 1: Everyone who accesses payday-loan services is more or less the same.

Myth 2: This market is lucrative, and lenders currently in the small-dollar credit market are gouging.

Myth 3: There is *an* alternative to payday-loan products.

MYTH 1:

Our research clearly identified a variety of different consumer demographics within this market, and payday-loan users are not a homogenous group—far from it, in fact, based on both behavioural and socioeconomic factors. With this in mind, we discuss customers in three socioeconomic segments: convenience-oriented, working poor, and the hard to bank. We have further assessed them based on four consumer-behaviour profiles that describe the reason customers borrow: unexpected expenses, misaligned cash flow, planned expenses, and ongoing shortfalls.

MYTH 2:

While the current rates chargeable on payday loans in Alberta when annualized would run at close to 600% APR, they do not actually provide returns to the lenders that are as lucrative as one might expect.¹⁰ In fact, investigating a range of lenders brings to light the consideration that there are significant expenses in the delivery model, in the risk factors for customers with thin or impaired credit ratings, and in default rates, all of which not only make this a low-margin business but also underscore the prediction that a sustainable alternative will need to overcome some significant challenges.

MYTH 3:

Small-dollar credit plays an important role in allowing lower-income individuals and families to maintain financial stability, but the solution to the existing faulty structure is not simple nor is it a “one size fits all.” A fair, scalable, and sustainable solution is not a single approach or a single alternative but a continuum of financial models and delivery channels, targeting different consumer segments and meeting customers where they are. If we are to achieve scale, solutions are not likely to be successful if implemented in isolation, and they will need to be the result of collaboration among government, financial institutions, other lenders, and the community.

FINANCIAL INSTITUTION PRODUCT INTERVENTIONS

Three years
28,000 loans
\$14 million

\$27 million in impact
5:1 social return on investment

\$8 million in support
70% charitable

ALBERTA MARKET SHARE MATH

Service Alberta PDL Statistics

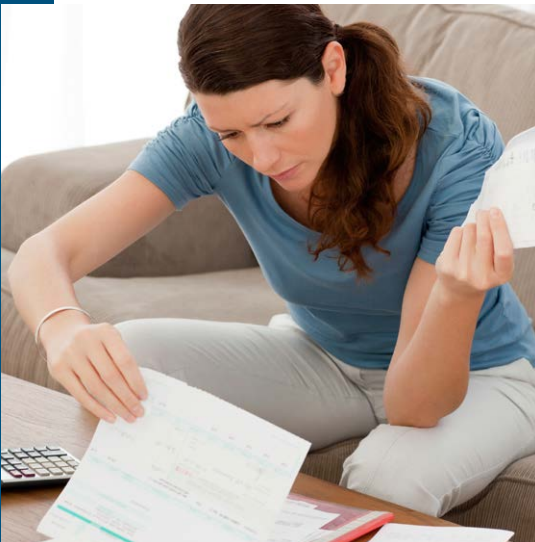
- \$525,000,000 loans disbursed/year
- 240,000 customers
- Average loan size of \$450
- Average 4.86 loans/customer/year
- \$525,000,000 loans disbursed
- Divided by 4 (removing rollovers)
- \$130 million market of cash actually placed in customers' pockets

YEAR THREE OF THE FINANCIAL INSTITUTION (FI) PRODUCT INTERVENTIONS

- \$7.2 million disbursed (per year)
- 14,600 loans
- \$130 million market (annual)
- 55% of the market earns less than \$45K/yr
- \$72 million “vulnerable” market
- 5.5% disruption of the entire market
- 10% disruption of the “vulnerable” segment

What follows includes an analysis of the complex payday-loan customer, the payday loan, the alternative small-dollar credit marketplace, and recommendations for possible alternatives to make small-dollar credit available in a manner that is enabling to the customer and not detrimental to society or business as a whole.

Who We're Working For: The Complex Payday-Loan Customer



ALICE is an acronym used to describe the payday-loan industry's target customer.

Who Is the Alberta Payday-Loan Customer?

Meet ALICE,¹¹ a twenty-eight-year-old single mother of two. She is employed in full-time shift work as a medical technician, but some months she gets more shifts than others. Alice makes about \$36,000 a year. Alice is very familiar with budgeting but between living expenses and childcare, with only one household income, she is struggling significantly. She has over-extended her credit card and turned to payday loans to meet living expenses. Alice does not have any significant assets, has a small amount of savings, and lives in modest rental accommodation. Alice uses payday loans to bridge the gap between her utility and rent bills and her upcoming pay cheque, particularly on months when she has worked fewer shifts.

Alice is not just an example we have invented. ALICE is an acronym used to describe the payday-loan industry's target customer by DFC Global Corporation (DFC), the owner of Money Mart, which is the largest payday lender in Canada and one of the largest in the world. ALICE stands for "asset-limited," "income-constrained," and "employed."¹² DFC and other payday lenders fill a gap left by banks and other financial institutions that underserve customers who require cash quickly do not have the income or collateral to qualify for traditional loans and/or who need an amount smaller than financial institutions normally lend.

"In early 2005, the Financial Consumer Agency of Canada placed questions on the Canadian Ipsos-Reid Express (CIRE) – a national omnibus poll of Canadian adults – about Canadians' experiences with, and motivations for, using cheque-cashing and payday loan services. The survey found that approximately 7% of survey respondents had used a cheque-cashing or payday loan company. Cheque cashing was the most frequently used service (57%), followed by payday loans (25%) and tax refund anticipation loans (5%). Certain respondents were more likely to have used these services including men between the ages of 18 – 34 years; living in urban areas in BC, AB, SK and MB; whose household incomes were less than \$30,000 per year; and those with some post-secondary education."¹³

There has been significant growth and change in the payday loan industry since 2005 with little completely independent research having been done. However, in 2016, Deloitte¹⁴ conducted research on payday-loan customers in select cities in Alberta on behalf of the Canadian Payday Loan Association, using 2015 data from customers of leading small-dollar lenders Money Mart, Cash Money, and Cash Canada. With this information, they calculated the average gross income for payday-loan customers in six Alberta cities, resulting in a critical finding: Payday-loan customers are average Albertans with near median household incomes of around \$50,633.

Deloitte further observed that as the average customer income increases, the average frequency of payday loans generally also increases, although the total number of customers decreases. It would appear that customers who have an income greater than \$50,000 on average take eight or more payday loans per year compared with five or fewer at the lowest levels of income. These results are consistent with those from the Center for Financial Services Innovation (CFSI),

which found that 57% of Americans are financially struggling.¹⁵ Certainly, this underscores how widespread both consumer challenges and business opportunities are.

Interestingly, a recent survey conducted by the University of Calgary's Haskayne School of Business found that the frequency of payday-loan use among a sample of low-income Calgarians was not contingent on gender, age, employment, ethnicity, or how often they receive a pay cheque (Herremans, 2016).¹⁶ In particular, among the almost 50% of the sample who had used payday loans at least once in the past, demographic factors did not significantly predict how often payday loans were used. Having identified that, at least economically, payday-loan customers are average Albertans, and that demographics alone don't explain how consumers come to use payday loans, we must next understand the behaviour profiles that lead customers to choose these products, and at what frequency.

Customer Behavioural Segmentation

Understanding the customer's financial situation and behaviour affects everything from product design and credit criteria, all the way to marketing and collection techniques. While socioeconomic segmentation gives some insight into where a provider will focus, the CFSI conducted a thorough segmentation analysis focusing on behavioural profiles of small-dollar credit customers and their financial health that provides insight into why customers choose these products in the first place.¹⁷

It is important to note that while income significantly influences financial health, consumer behaviours like those involved in planning ahead or saving have a considerable bearing on consumers' financial health. This financial health includes the smooth and effective management of day-to-day financial life, resilience in the face of life's ups and downs, and the capacity to seize opportunities that enable financial security and mobility. These behavioural segments include:

- Unexpected Expenses
- Misaligned Cash Flow
- Planned Expenses
- Ongoing Shortfalls

UNEXPECTED EXPENSES

About 28% of customers borrow from time to time to meet unexpected expenses such as a vehicle breaking down, medical bills, or home repairs.¹⁸ Such customers (47%) tend to take out only one to two loans per year, and although often facing constrained access to traditional credit, a third (32%) have some savings at the time of their small-dollar loan, as well as more stable finances.

MISALIGNED CASH FLOW

Some customers use small amounts of credit on a fairly regular basis to even out the mismatch between when their bills are due and when they are paid, especially those with fluctuations in the amount they receive in a given pay period. Such borrowers often use small-dollar credit to pay utilities, rent, and household expenses, and they tend to be among the most dependent users. For example, approximately half are moderate to heavy credit users; 42% use six or more loans per year; and 16% take more than twelve loans per year. Although their cash-flow shortages are recurring, they are usually short-term; however, chronic shortfalls can indicate that borrowers are exceeding their income.

Understanding the customer's financial situation and behaviour affects everything from product design and credit criteria, all the way to marketing and collection techniques.

Notably, viewed next to certain alternative choices, for some consumers using small-dollar credit in this way is a reasonable choice. For example, it is less expensive to access short-term, small-dollar credit such as a payday loan than to fall behind on utility bills. Consider this example, using figures drawn from a real Calgary utility company, for a customer facing a three month overdue utility bill:

Utility Amount Overdue:	\$450.00	Payday Loan	\$450.00
Bank NSF Fee	\$45.00	Payday Loan Fee	\$103.50
Dishonoured Payment Fee	\$20.00		
Late payment charge – 3.25% of balance	\$ 6.50		
Disconnection Fee	\$47.00		
Reconnection Fee	\$47.00		
TOTAL Possible Fees¹⁹	\$170.50		\$103.50

It can be less expensive to access short-term, small-dollar credit such as a payday loan than to fall behind on utility bills.

This example of the fees charged does not indicate how the original balance of \$450.00 owing is going to be paid without the loan, or how the principal of the loan will be repaid in the payday-loan example. Yet, it makes sense to incur only \$103.50 in fees rather than the \$170.50 that would be charged if the utilities were in danger of being disconnected. These types of situations are what lead 20% of payday-loan users to borrow: so they won't bounce a cheque or incur late fees on routine bills.²⁰

ONGOING SHORTFALLS

Customers who regularly have expenses that exceed their monthly income are among the highest users of small-dollar credit, although the amounts they borrow are normally \$300 or less. These customers are the most likely to use payday loans for general living expenses such as food or clothing. We concur with the research done by CFSI that providing credit to individuals with a chronic income shortage puts them at further risk and adds to their stress rather than helping the situation.²¹ Referring them to 211 to access Basic Needs funding is likely the better option, although customers with this profile currently make up about 35% of all payday-loan users.²²

PLANNED EXPENSES

These borrowers occupy a unique niche within the small-dollar credit market, in that they use small-dollar credit to make a relatively large planned purchase (e.g., car, home repairs, furniture and appliances, small business expenses, etc.). These are the most financially stable of all small-dollar credit users, borrowing less often (i.e., 51% borrow once or twice per year) and borrowing a larger amount on average (i.e., 50% borrow \$1,000 or more per loan). These are the customers most likely to have options as to how they obtain their credit, are most often accessing term loans, and 65% of these customers have savings at the time of the loan.

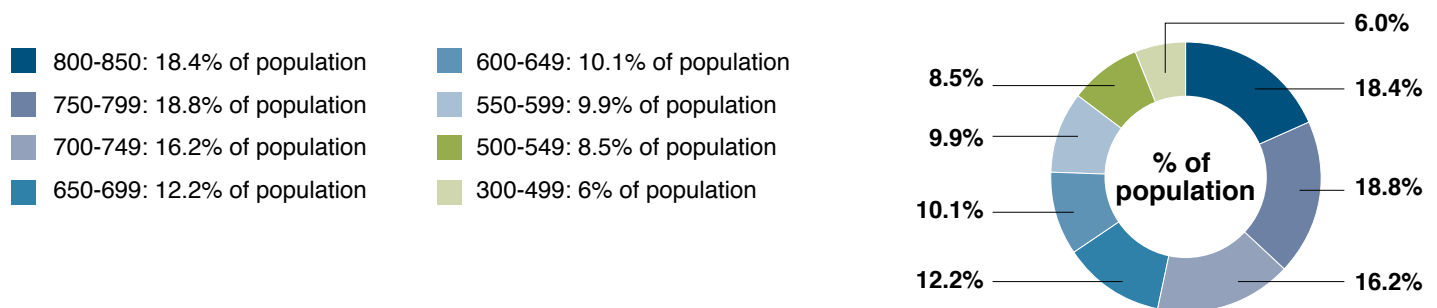
Customer Risk-Profile Segmentation

Credit scores are used by a vast majority of mainstream but not small-dollar lenders as a means of evaluating the risk profile of a given customer. The score suggests how likely a given customer is to repay the loan without incident, or whether it is likely that obtaining repayment will require additional investment on the part of the lender. Below is a chart depicting the anticipated default rates of customers with various credit scores.

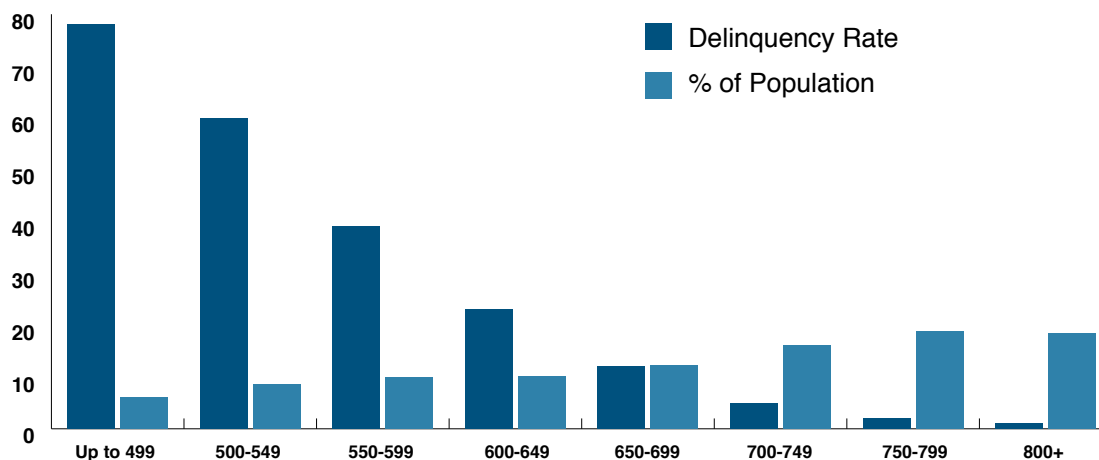
Mainstream financial institutions prefer to lend to customers with credit scores above 660, and given the above it is not difficult to understand why. However, consumer credit scores as measured by FICO are distributed across a number of ranges²³:

This means that a full third (34.5%) of consumers can expect to largely be excluded from borrowing at a mainstream financial institution on the basis of their credit score alone, and this is a striking percentage of Canadians left underserved—except by payday lenders.

Credit Scores



Canadian banks are world renowned for their stability throughout good times and bad. The cost of this stability is reflected in the low loan-loss ratios that the banks' credit models tolerate. A study by PricewaterhouseCoopers published in 2016²⁴ shows that Canada's major banks held loan-loss provisions at the end of 2015 of well under 1% for their combined commercial and personal lending portfolios. With commercial lending-loss provisions making up the lion's share of this, loan-loss provisions for the personal lending portfolio in isolation are well beneath .5%. This is compared to the latest data we have on payday-lending companies from a 2009 Ernst & Young study of US payday lenders,²⁵ which shows a loss rate of 4% of total loans issued, after recoveries, four times what Canadian banks would normally expect. Recognizing that this rate of 4% includes loan results for the much larger, multiline lender with a more stable portfolio of loans taken by higher-income earners, the loss ratio for ALICE and the most vulnerable segments using payday loans would be much higher.





HARD TO BANK

Given this significant difference in risk, it is understandable that financial institutions would hesitate to lend to Alice and customers like her. In order to consider doing so they would need to see a true long-term profitable business opportunity or find a risk-sharing model. We propose examples of such models in the sections that follow.

Those who choose small-dollar credit out of convenience and not need and/or whose credit scores do not preclude them from borrowing from a mainstream bank but still choose to use payday lenders are beyond the scope of our report. We will focus instead on two segments that warrant consideration: those who are hard to bank and the working poor.

Customers with credit scores below 600 are difficult to lend to with confidence of repayment. If loans are provided to this group, there is greater risk of default, and that greater risk needs to be reflected in the rate charged for the loan unless the loan is being provided on a philanthropic basis. On a philanthropic basis, organizations that lend to customers in this segment either with partial or complete philanthropic backing typically do so in order to a) provide assistance where it is needed, and b) create a means for customers to improve their credit scores.

For example, the Desjardins Mutual Assistance Fund provides small-dollar credit in collaboration with budget consulting organizations in Quebec and Ottawa. To obtain the financing, customers must be a member of a participating *caisse populaire* (credit union), agree to produce a budget with the assistance of budget consulting experts, and be evaluated as able to repay the loan. Financing of \$500 to \$1,500 is available through an interest-free loan with a repayment period of 12 to 24 months, depending on the amount granted and the borrower's financial capacity.²⁶



WORKING POOR

Members of this group are employed, although often below the median income level. They are living pay cheque to pay cheque with little to spare, and surprise expenses are often a near-catastrophe for them financially. Their credit scores are often just below the level that mainstream financial institutions feel comfortable lending to, although many are likely to have at least one credit card.

In order to lend to this segment with confidence, alternative lending criteria need to be used. This can most easily and cost-effectively be achieved through the use of technology that takes into account rent and utilities records (Fair Isaac, US), psychometric testing (EFL, Peru), social media scoring (Lenddo, Mexico) and/or cell phone data (Jumo, South Africa).

Example: *LexisNexis® RiskView™ Solutions uses a comprehensive suite of proven credit-risk management data analysis tools and non-tradeline data to facilitate loan underwriting. These credit-risk modeling tools can increase the predictive intelligence far beyond traditional credit bureau scoring. Drawing on public records and multiple proprietary data sources, RiskView™ Solutions provides a greatly enhanced understanding of the risk, scoring, profitability potential, and creditworthiness of customers and prospects.²⁷*

Example: *QCash technology automated a relationship-based underwriting decision engine that has allowed the Washington State Employees Credit Union to book more than 30,000 loans annually, maintains loan-loss rates in the 6–8% range, provides financial education for members using this product, and generates a \$4 million/year net profit.²⁸*

DEMOGRAPHIC AND CUSTOMER SEGMENTS

SOCIOECONOMIC



HARD TO BANK

- Sub 600 credit score
- Severe income limits (AISH, Income support)



WORKING POOR

- 600 to 660 credit score
- Employed, under median income



CONVENIENCE

- 660+ credit score
- Above median income
- Often younger (Millennials)

CONSUMER BEHAVIOUR

ONGOING SHORTFALLS

- (Heavy Users)
- Should be referred to basic needs agencies

UNEXPECTED EXPENSES

- (Light Users)
- Less need for financial literacy training

MISALIGNED CASH FLOW

- (Frequent Users)
- Best candidates for financial literacy training

PLANNED EXPENSES

- Reasonable market options for financing exist

CHARITABLE

HIGHEST-IMPACT SEGMENT

MARKET

Recommended Target Segments

The customers that we feel can be positively impacted most through the provision of more affordable small-dollar credit are the working poor, where there is either a mismatch between when their bills are due and when their income is available, and those faced with unexpected expenses. It is with these segments in mind that we will make our recommendations regarding possible affordable short-term credit options.

Struggling to Make Ends Meet: The Not-So-Lucrative Payday-Loan Business



Although many Albertans are familiar with the term “payday loans,” an understanding of the role that payday lenders play in the financial services industry and who their customers are is lacking across all stakeholder groups, including customers themselves. Many myths and misconceptions exist, and misinformation has led to polarization in the industry. Our hope is to help shape an informed understanding of payday loans, lenders, and customers. For instance, as our earlier utilities example indicates, payday loans can be economically helpful for some people who need access to cash quickly to prevent even greater costs and to whom traditional sources of credit are not available.

Although for some, payday loans are a reasonable option among the available alternatives (or lack of alternatives), for others it can mean entry into a spiral of debt that is inescapable. Our intent is to move beyond contentious language about these products (e.g., “predatory”), which we feel drives stakeholders to defensive positions where the sharing of best practices is difficult to achieve. In our effort to better understand how this service that is filling a marked gap in the lending continuum can be improved to better serve customers, we begin with a review of payday loans and lenders, followed by a review of regulators and the role of regulatory change.

Payday Loans: Profitability, Interest Rates, and Expenses

It is a commonly held belief that the payday-lending industry, when charging up to 600% APR, must be reaping massive profit margins. Studies completed by independent auditors and academic researchers fail, repeatedly, to confirm these claims. One of the most independent studies, a 2007 report published in the *Fordham Journal of Corporate & Financial Law*,²⁹ showed that the American payday-lending industry was earning a modest 3.57% profit margin, while mainstream lenders (i.e., banks and other consumer credit companies) were averaging 13% returns.³⁰ These figures were compiled before the most recent round of credit cost tightening enacted by various provincial authorities, so it is highly likely that the results are not much better in Canada. In short, high payday-loan interest rates do not translate to high rates of return.

This might lead to the seemingly obvious conclusion that for payday lenders, loan losses (or the extent to which loans fail to be repaid) are the dominant expense category. While studies over time do show that a historical average loss rate in both the US and Canada comes in at 20% of revenue, the far larger operating expenses are staffing and the cost of brick-and-mortar locations.³⁰ The cost of the convenience demanded by payday-loan consumers, locations in neighbourhoods often underserved by banks, and hours extended far beyond the most flexible mainstream financial institutions result in significant costs for payday-loan providers. Not only are interest rates not as profitable as it might seem, neither is customers' failure to repay the most significant expense for payday lenders. Rather, it's the cost of meeting the unique needs of their customer segment.



Small-dollar short-term high-touch convenience oriented loans are expensive to administer.

Cost Analysis

Operating cost per \$100 loan	\$ 12.84
Cost of loan capital	0.56
Cost of supplementary capital	0.99
Cost of \$100 loan before bad debt costs	14.39
Bad debt cost per \$100 loan	6.35
Total cost of \$100 loan	\$ 20.74

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Change Is Needed: Shifting the Payday-Loan Business

The payday-lending industry in Alberta needs to change. The existence of multiple storefront locations, servicing a relatively small number of loans and at a high overhead, is an unsustainable situation. The business model of a loan with limited underwriting where both principal and interest must be repaid within days and the interest charged is high needs to be reimaged in order to be both scalable and sustainable for customers and lenders. Companies currently offering small-dollar credit need to move more quickly from monoline to multiline models so that existing small-dollar credit providers expand their product lines to include, for example, remittance products, cell phone support, lottery sales and/or other services of value to customers in their segment. In addition, improvements to lending technology and an increase in product availability through other retailers currently serving these segments would further enable the necessary change.

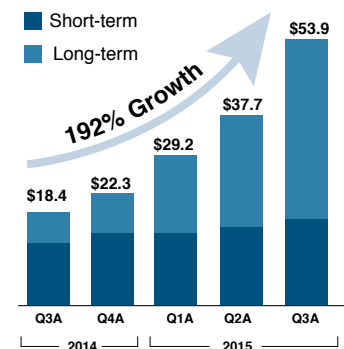
PRODUCT EXPANSION: CURRENT PAYDAY LENDERS

In the US, this shift is well underway. A 2009 study by independent auditors Ernst & Young³³ indicated that 49% of the revenue attributed to payday-lending companies was actually from products other than payday loans (e.g., remittances, gold purchases). While similar data are not readily available in the Canadian marketplace at this time, interviews with existing lenders in Alberta indicate that the diversification of revenue is not at this level in Alberta.

In addition, focusing on delivering larger, longer-term loans to the “prime” lending market (i.e., those with higher incomes and credit scores above 660) is another corner piece to a well-diversified business strategy. While these loans have significantly lower margins, the size and relative ease of origination and collection is a healthy offset. Q3 financial results delivered by Mogo,³⁴ a Canadian digital financial platform, show small-dollar, short-term credit as a quickly diminishing portion of their overall growth.

Long-term Loans Driving Receivable Growth

Gross Loans Receivable
(\$ millions)

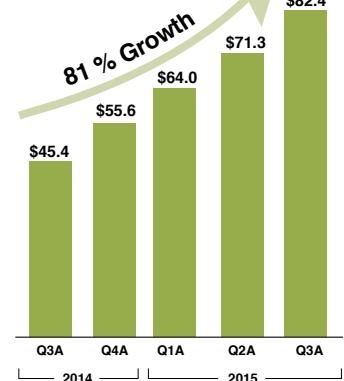


MOGO

Source: MOGO Q3 Financial Results

Loan Originations

(\$ millions)



MOGO

Source: MOGO Q3 Financial Results

In addition to the term of the loan, technology should be used to provide alternate underwriting and to assess the ability of the borrower to repay.

Existing retailers are well positioned to meet the convenience needs of customers. This would not only improve availability of credit services for customers, but also enable additional revenue for retailers.

LENDING TECHNOLOGY: INNOVATION IN BORROWER SCREENING

Considerable opportunity exists to improve on existing lending practices, while also providing a good customer experience for borrowers. In addition to the term of the loan, technology should be used to provide alternate underwriting and to assess the ability of the borrower to repay. This will both reduce loan-loss expenses and increase the number of approvals that are currently being declined. Much of the innovation in this area has arisen in developing-nation contexts, where robust credit bureau systems do not exist. Many providers who have developed screening tools in emerging economies are now turning their sights to the North American small-dollar credit market as well.

Inspiration for using technology to reduce costs in a highly technical and historically face-to-face discipline exists in the field of medicine. For example, Appletree Medical Group uses self-registration kiosks into which patients enter health card information and provide a short description of the reason for their visit, allowing for shorter wait times and access to the best available doctor in their network.

Lenders can learn from such a model, and all groups need to continue to grow the servicing of a broader range of customers by also providing larger, more innovative credit products to a broader segment of the population to help spread costs.

AVAILABILITY EXPANSION: EXISTING RETAILERS

Another opportunity for meeting the needs of this segment exists for merchants who already provide other products and services. For example, Walmart Canada, 7-11, and others could expand their offerings to include small-dollar credit, which would provide good retail and opening-hours coverage for customers without the burden of supporting such an infrastructure with a single-service business, as many payday lenders are doing. That is, existing retailers are well positioned to meet the convenience needs of customers, at a fraction of the expense. This would not only improve availability of credit services for customers, it would enable additional revenue to be generated to offset fixed costs such as premises and semi-fixed costs such as staffing.

In summary, there are several things that need to change in the current payday-lending industry to ensure that businesses are providing the best possible experience to their customers while at the same time operating profitably. Product line expansion, innovation in borrower screening, and availability expansion are among them.

Policy and Community-Based Interventions: Regulation and Education

Most people have credit requirements from time to time, but the unbanked and underbanked who can least afford it are forced to obtain credit under the most unfavorable terms. This needs to change. We believe that all three levels of government, as well as investors, philanthropists, financial institutions, community-based lenders, employers, social enterprises, select retailers and, with modification of the current business model, payday lenders, all have roles to play.

Role of the Regulator: Seeing Beyond Rate

Regulatory changes are necessary, but they need to be assistive rather than destructive. There has been a focus on the maximum allowable charge per hundred dollars borrowed in the provincial regulations across the country when this may not be the most important aspect of the product to focus on. Although it may be the fastest way to change the industry, it may not be the most effective way to make small-dollar credit accessible to individuals in need and at a reasonable rate. More effective approaches may include extending repayment periods, requiring credit bureau reporting, monitoring and regulation of online lenders, revisiting postal banking, and providing support for the most vulnerable in society.



Simply regulating rate can range from having limited to very negative consequences for customers. Loan term length is as critical as rate in protecting and breaking the current payday loan “cycle.” In order to be scalable and sustainable, this model needs to change. In addition, small-dollar loans need to be reported to the credit bureau so that customers who pay as agreed are able to *build* their credit files, and those who default will have their ability to borrow even at a high interest rate reduced.³⁴

Further, significant effort from government must be placed on monitoring and control of the unregistered online market, as it represents the largest risk to customers if the current model is abandoned before alternatives are in place.³⁵ The most recent statistics available (Cardus 2016³⁶; Policis 2015³⁷) show that while Canada’s percentage of online payday-loan originations is minimal at 10%, the growth in other countries (34% in the US and 80% in the UK)³⁸ forecasts a growing trend toward online origination.

Significant effort from government must be placed on monitoring and control of the unregistered online market, as it represents the largest risk to customers if the current model is abandoned before alternatives are in place

Significant effort from government must be placed on monitoring and control of the unregistered online market.

The same Policis report indicates that six in ten US online lenders are not registered by the appropriate state authority, and that 40% of those illegal lenders operate from offshore jurisdictions that are relatively untouchable by US regulators. "Online illegal lenders are used by 2.4 million US consumers, primarily the higher risk and more vulnerable borrowers."³⁹

These illegal small-dollar loans represent 21% of all payday lending in the US. The risks encountered by users of illegal lenders are many:

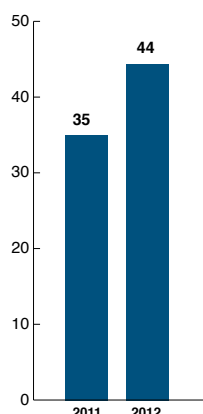
- 32% of borrowers experienced an unauthorized withdrawal from their bank account.
- 39% reported that their personal and financial information had been sold to a third party.
- 30% report being threatened by a lender.

In addition, many of these online lenders ignore price and product controls, often disguising negative product attributes. One US regulator was quoted as saying that 99% of their complaints were regarding unlicensed lenders.

These illegal small-dollar loans represent 21% of all payday lending in the US.

Texas: Following regulatory change in 2012, illegal lenders increased their share of online lending volumes.

Share of all online small sum high cost lending in Texas represented by illegal lenders 2011/2012.

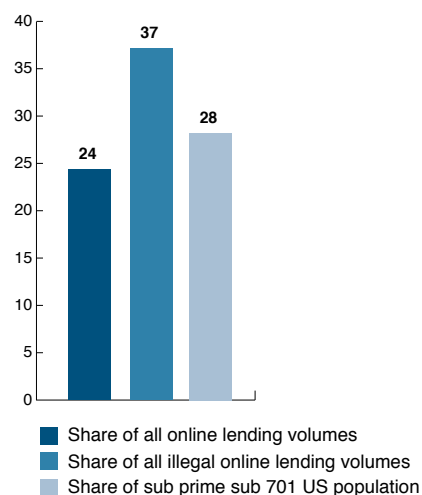


In Texas state-wide, the share of online payday lending represented by illegal lenders rose from 35% in 2011 to 44% in 2013 following the introduction of a new payday loan ordinance in Texas on 1st Jan 2012 which restricted supply.

Source: Policis. Estimates based on Clarity Services Data.

Almost 4 in 10 illegal payday loans in the US are being made in states where payday loans are actually or effectively banned.

Share of all online and illegal online lending in US occurring in 14 US states where payday lending banned or effectively banned.



Base: 14 States where payday loans are banned or effectively banned.

Source: Policis. Estimates based on Clarity Services Data.

The Policis report concludes by saying that while regulatory restrictions do decrease some of the “impulse” demand driven by proximity and advertising, the underlying demand remains and drives growth in the unlicensed industry.⁴⁰ That is, there is an imperative not just to regulate. There is an imperative to find constructive ways to meet demand.

At a federal level, postal banking should be re-examined as a national initiative. Various reports have studied this issue and highlighted the positive results in other countries, yet Canada continues to shelve this important option. The potential for both taxpayers and customers has been calculated to be significant.⁴¹

Lending to individuals who are unable to repay further increases their distress without solving their longterm problem. Ongoing reviews of income supports for vulnerable populations (AISH, OAS, and Alberta Works income supports) need to continue as priorities to ensure that the most vulnerable populations do not need small-dollar credit in the first place. Some customers are not candidates for payday loans and need to be supported in other ways, including financial education and “Compassionate Loans” lent at no more than 10% of income, which we discuss in the following sections.

Lending to individuals who are unable to repay further increases their distress without solving their longterm problem.

Summary of Possible Regulatory Changes

Regulation Change	Description
Interest Rate	Needs to be reflective of risk without eliminating lenders
Term	Repayment period extended to allow successful repayment
Credit Bureau Reporting	Repayment as agreed builds the client's file; lenders are more aware of the borrower's outstanding loans and repayment history
Underwriting Criteria	Limit lending to fixed-income recipients (maximum 10% of income)
Online Lender Monitoring and Control	Monitor and regulate all online lenders
Postal Banking	Examine postal banking option to increase availability and accessibility of small-dollar credit, while spreading costs

Education: The Role of Financial Literacy

One of the seven key features of affordable small-dollar credit programs recommended by the US Federal Deposit Insurance Corporation (FDIC) in their 2008–2009 small-dollar loan pilot program was financial education.⁴² Bankers from the 28 participating banks⁴³ all recognized the importance of savings and financial education but differed in their opinions as to whether or to what degree these features should be required as part of a small-dollar credit program. Some felt strongly that these features should be a core component of small-dollar credit programs to help build financial resiliency and reduce reliance on high cost debt. Others felt that making financial education and saving requirements for obtaining small-dollar credit added to the time to access the loan and increased the stress of the borrower. This second group felt that some basic financial education should be provided by the banker during the application and loan closing processes.⁴⁴

Our view is that financial education should be addressed twofold.

We believe that financial education is important to help build the financial knowledge of all borrowers, and would recommend programs such as the Each One, Teach One program Vancity has been facilitating. Topics include taxation and tax filing, contracts, and developing a credit history. Other sessions cover basic banking and budgeting, and understanding the credit bureau, loans, credit cards & prepaid cards, seniors financial abuse prevention and fraud prevention.⁴⁵

Second, our recommendation is that financial literacy be made available to small-credit borrowers through personal recommendations at the time the loan is taken out, and also that the lenders be prepared to make referrals for more in-depth financial education and counselling should the customer be open to participating. We would not advise formal financial literacy participation as a requirement of obtaining credit, as that slows down the approval process, may be a barrier in the mind of the borrower that encourages choices of less constructive alternatives, and presents a cost and time barrier for the system that we suggest would make it difficult to scale. We examine in more depth the process and products for payday-loan alternatives in the next section.



There Is No One Scalable and Sustainable Solution. There Is a Continuum.

Momentum and some of their community partners desire to accelerate innovation in small-dollar credit that augments the payday-lending market. Their goal is for scalable and sustainable alternative lending to potentially reach 10% of the small-dollar credit market share in Calgary. To achieve this they have asked us to explore:

- How to leverage financial institution infrastructure with the goal of working with at least three financial institutions to provide alternative loan products
- The possibility of leveraging a pool of capital so that financial institutions can provide affordable, short-term loan products to lower-income Albertans as an alternative to payday loans
- Opportunities to build on the “Cash Crunch” micro loan test project with First Calgary Financial.⁴⁶

Eliminating current payday lenders without providing viable alternatives for customers with a range of vulnerability could have the unintended negative outcome of forcing borrowers to meet their short-term credit requirements through unregulated means that would further exacerbate their already tenuous financial health. Alternatives need to be structured in a way that helps borrowers to pay down high-cost debt and increase their traditional credit score in order to provide them with the opportunity to access mainstream financial services.

When individuals or families experience fluctuations in their employment income or expenses and do not have personal savings to draw on to cover costs, they need access to safe small-dollar credit. The current payday-loan model does not provide a win-win option for borrowers because the profitability of the lender depends on significant repeat usage by the borrower.⁴⁷ For example, small-dollar credit that is delivered as a standalone product is nearly impossible to provide on a profitable basis without charging high fees and rates of interest. One imperative of a good alternative will be the ability to deliver small-dollar credit at a lower cost than that of the current payday-loan model.

Models that are developed with a view to the customers' overall long-term financial health take into account their day-to-day banking and savings requirements in addition to their immediate need for credit. Currently payday lenders are not able to provide deposit-taking services, so it is difficult for them to adjust in ways that would allow their model to provide a fully franchised experience for the customer. Innovative thinking is needed to create credit products that meet the needs of these borrowers while allowing for profitability or at least the ability to break even for the lender.



The current payday-loan model does not provide a win-win option for borrowers because the profitability of the lender depends on significant repeat usage by the borrower.

Principles for Developing Fair, Scalable, and Sustainable Services

Empowering small-dollar credit can be structured in a way that enables individuals to address their immediate needs, while at the same time allowing them to build their credit and improve their financial future. It is a balancing act to provide small-dollar credit profitably without excluding borrowers unnecessarily. The underwriting process needs to be streamlined with the help of technology that allows for alternative repayment indicators to be incorporated into the decision-making process. Borrowers need choice in the amount of the loan as well as the terms and timing of repayment.

In 2012 the CFSI developed the Compass Principles⁴⁸ as guidelines for the financial services industry. Their vision stems from the belief that financial services offerings must be profitable and scalable from a business standpoint in order to offer lasting solutions for customers. These principles and their application must be grounded in the knowledge of consumer needs and demand, as well as the desire to meet those needs safely and responsibly over the long term, and thus were used in formulating our recommendations. These principles are:

- Embrace Inclusion – Responsibly expand access
- Build Trust – Develop mutually beneficial products that deliver clear and consistent value
- Promote Success – Drive positive consumer behaviour through smart design and communication
- Create Opportunity – Provide options for upward mobility

The principles are a framework for developing services, and they recognize that one organization will not be able to meet the needs of the wide spectrum of customers. If all providers find a market segment they are able to serve profitably through a variety of high-quality small-dollar service offerings, we can together make a significant difference for currently underserved customers. The CFSI has developed guidelines for what features an empowering small-dollar loan should include,⁴⁹ and the Cardus (2016) report has summarized each of the guidelines based on an analysis of the structural issues of payday loans.⁵⁰ According to CFSI and Cardus, an empowering small-dollar loan has the following characteristics:

Characteristics of the

1. It is made with a high degree of confidence in the borrower's ability to repay

A single payday loan can result in months of successive repeat borrowing and a substantial amount of money lost to fees, due to a lack of assessment of the borrower's ability to actually afford or repay their loan. Lenders should employ strong underwriting techniques, which may include use of technology and other innovative tools, to assess the financial position of the borrower, and they should offer only alternatives that suit the customer's ability to repay.⁵¹

2. It is structured to support repayment

Short-term lump-sum payment is a key issue with the current payday-loan model, and it is vital to structure an alternative product or products with payments that are affordable for the borrower. Loan options that vary in dollar amount, length, and payment schedule that are based on the borrower's financial situation and repayment ability can dramatically improve repayment.⁵²

Other safeguards can contribute, such as a limit on the number of loans within a given period to prevent overuse, or providing flexibility to a borrower struggling to pay.⁵³ Reducing default rates and the prevalence of repeat borrowing can be achieved through innovative loan structures that enable customers to avoid costly fees and a cycle of debt.⁵⁴

The principles are a framework for developing services, and they recognize that one organization will not be able to meet the needs of the wide spectrum of customers.

Empowering Small-Dollar Loan

3. It is priced to align provider profitability with success for the borrower

Although payday lenders currently rely on repeat borrowing for profitability, revenue-generating elements of a loan can be built to align with borrower success. For example, rather than relying on penalty fees and re-borrowing to drive profits, lenders can reward borrowers who demonstrate positive behaviours with lower costs and other benefits that might include different financial services.⁵⁵ Such a transformation will require lenders to derive value from borrowers who are able to pay off and stave off debt, yet it has the potential to yield a more profitable and sustainable overall business model.⁵⁶

4. It creates opportunities for upward mobility and greater financial health

Under the current structure, payday loans do little to enable borrowers to access higher-tier credit products, build savings, or improve their overall financial health. For example, payday lenders do not report successful repayment to credit bureaus, reward positive behaviour with access to better rates, or provide products or incentives to enable borrowers to build savings. CFSI suggests that a high-quality credit product should provide incentives, rewards, and support to help borrowers access better credit, build savings, and manage credit well—all areas where there is alignment between consumer success and profit.⁵⁷

5. It has transparent marketing, communications, and disclosures

It is critical to emphasize the importance of disclosure in delivering high-quality small-dollar credit, even though Canadian regulations already recognize its importance. Research finds that some borrowers do not fully understand the costs associated with use of payday loans, and there is evidence to suggest that behavioural interventions in how information is disclosed can affect loan usage.⁵⁸

6. It is accessible and convenient

It is important that high-quality small-dollar credit remains accessible and convenient for borrowers, which are the main drivers for payday-loan use relative to other credit products. However, these attributes must be balanced with a borrower's ability to repay a loan. Innovative loan structures and flexible delivery models that can meet a variety of needs and increase a borrower's ability to repay are key means through which this market can be improved. Developing an efficient application and approval process that is both quick and effective at assessing a borrower's financial position is important for high-quality small-dollar credit.⁵⁹

7. It provides support and rights for borrowers

Some disputes and defaults are inevitable when small-dollar credit is designed to be accessible and inclusive, no matter how rigorous the assessment process or loan design. It is important to ensure there are processes and practices in place for fairly providing support and resolution for the borrower, which is important for customer well-being. Importantly, such helpful, accessible, and respectful customer support is key to building strong and lasting relationships with borrowers that facilitate mutual long-term success.⁶⁰

8. It uses creative marketing to reach critical mass

Some well-designed small-dollar credit products rely on high volumes for profitability, making it particularly important that prospective borrowers are aware of them. Creative marketing campaigns that are well targeted for focal segment(s) should be designed, then communicated through channels that may include transit advertising and partnering with key community organizations.⁶¹

An empowering small-dollar loan is fair, scalable, and sustainable—and centered on supporting customers in moving toward financial health.

With these criteria in mind, we outline four key recommendations in the next section.

Recommendation 1:

Compete Where the Customers Are

Recommendation 2:

Engage Financial Institutions

- **Tactic 1:** Building Financial Health as a Core Business Strategy
- **Tactic 2:** Partnership between Financial Institution and Community Partner, with Philanthropic Support
- **Tactic 3:** Built-in Savings Program

Recommendation 3:

Alternatives Not Involving Financial Institutions

- **Tactic 1:** Employer Benefit – Payroll Deduction
- **Tactic 2:** Mini Loan & Savings Program with Financial Coaching Through Community Lending Centre
- **Tactic 3:** Refer from Community Partners to an Online Provider

Recommendation 4:

Serving the Most Vulnerable Customers, and Referrals to a Wider Range of Providers

Recommendations

1

Compete Where the Customers Are

Our first recommendation centers on competing in the marketplace in the same manner in which customers are used to meeting their credit needs. Specifically, this would involve purchasing an existing payday loan business, partnering with a payday lender if regulations allow, or creating a new payday lender, and developing a business model focused on improving the financial health of customers.

A purchase would be best if made by a financial institution large enough to facilitate it, and with the willingness and ability to support customers in becoming primary users of more mainstream banking services. Services could be designed to meet the financial needs of small-dollar borrowers on a more cost effective basis than can be realized by a monoline lender, and there would then be no need to entice customers to change the place they are used to doing loan business with. Kinecta Federal Credit Union provides one such successful example.

Example:

Kinecta Federal Credit Union is one of the USA's leading credit unions, with more than \$3.6 billion in assets and serving over 270,000 member-owners across the country. This institution is committed to setting standards of excellence in every aspect of its organization by remembering that its business is serving members.

Kinecta purchased Nix Check Cashing in order to better serve underbanked customers in southern California, beginning with an existing customer base from which to build. Nix is now a wholly owned credit-union service organization of Kinecta Federal Credit Union. After Kinecta acquired Nix Check Cashing, the name was changed to Nix Neighborhood Lending. The new branding is aimed to position Nix as a neighborhood financial organization committed to building the communities it serves.

Nix meets the financial needs of customers at all levels—on their terms and where they live and work. Its business philosophy is built around the customer and customer experience. The tagline “You’re Somebody Special” echoes this sentiment and is reflected in customers’ trust in and loyalty to Nix. Nix has 35 branches spread between Los Angeles, Orange, and San Bernardino counties.⁶²

2

Engage Financial Institutions

Changes in regulation for the banking industry in the 1980s saw a move away from small-dollar credit, which then became accessible primarily through credit cards and overdraft protection. This left consumers with limited options for small amounts of credit for a relatively short period of time. Following an international trend, the payday-loan industry first emerged in Canada in the mid-1990s in response to an unfulfilled consumer demand for small-sum short-term credit.⁶³

Herremans' (2016) survey of low-income Calgarians finds that while almost all stated that they have a bank or credit union in their neighbourhood, 69% of payday-loan users (63% of overall respondents) indicated that they didn't approach a credit union because they were certain they would be rejected; 73% of payday-loan users (64% overall) said that their credit rating was too poor to get credit from a bank or credit union; and 61% of payday-loan users (60% overall) expressed the perception that the process at a bank or credit union is too slow. In sum, there is a necessity and opportunity for relationship-building between low-income Calgarians and financial institutions.

Financial institutions have a major role to play in empowering Albertans financially. However, in order to do that there will need to be a reconceiving of how financial institutions create and share value in the communities in which they live and operate. It is through core business activities that financial institutions can strengthen the financial health of their customers. Putting the needs of the customer, even the underbanked customer, at the center of product development could spark significant profitable innovation. Looking at the customer's pain points and creating solutions can develop new avenues for profitability. In this case financial institutions that are already experts in extending credit can choose to use their core competencies along with technological advances to meet the need for small-dollar credit at scale in a way that would be difficult for government or the social sector to replicate.

For example, National Australia Bank (NAB), one of the four largest banks in Australia, responded to the financial crisis in 2009 using a shared-value model. It began pursuing competitive advantage by providing fairer offerings to its customers. In addition to bank accounts with no fees, the bank created NAB Care, a program providing financial hardship advisory and loan-repayment options for customers who are struggling. NAB Care is part of the bank's core business, fully integrated with NAB's collections department, and the program also introduces a new approach to operations. Life Line, a mental health non-profit organization, was brought in to train all NAB's employees in recognizing and managing financial hardship among customers. Employee performance evaluations were modified to incentivize and reward staff for proactively managing customers' financial health. By the end of 2013 NAB saw a 20% reduction in loan defaults as a result of NAB Care employees' work with over 100,000 vulnerable customers. Cost savings of \$7.2 million have been realized as a result of 40% of this bank's customers proactively contacting NAB Care to seek advice before their loan becomes delinquent.⁶⁴

The 2015 NAB Corporate Responsibility Report indicates, "We have continued to make progress towards our mission of assisting one million low-income Australians with microfinance products and services by 2018. So far, over 394,000 Australians have received assistance—and we have used the things we have learned in promoting financial inclusion in Australia to support the development of financial inclusion in New Zealand, through our pilot community finance initiative."⁶⁵

2

Engage Financial Institutions (con't)**BUILDING FINANCIAL HEALTH AS A CORE BUSINESS STRATEGY**

A few innovative financial institutions have undertaken services focused on underbanked customers. Some have recognized this as an underserved and potentially profitable market, and others have identified serving all members of their communities as a strategic priority and moral responsibility.

All seeking to provide small-dollar credit as a mainstream service require strong support from an institution's leadership including the Board. Without support throughout the organization, a service like small-dollar credit for the currently underserved customer is unlikely to be successfully implemented.⁶⁶ Often, the investment in time, technology, and training to support such a service offering can be significant and may be considered "too costly" without a long-term view of the customer. This is in line with CFSI's Strategy 2: "Prioritize long-term relationships over short-term profits." Vancity presents a good example.

Example:

Vancity, Canada's largest community credit union with \$19.8 billion in assets, is a member-owned financial co-operative based in Vancouver.

Toward its vision of redefining wealth in a way that "furthers the financial, social, and environmental well-being of members and their communities," Vancity designed the "Fair & Fast Loan," an industry-first banking alternative to high-cost payday loans. Leveraging an innovative risk model, the Fair & Fast Loan provided an inclusive lending solution that saved Vancity's customers over \$2 million in interest and fees. It was the 2015 recipient of the National Credit Union Association "Innovation Award" and "New Product Launch Award."⁶⁷

Vancity worked closely with CFSI over the course of about three years to design the business model, deliver the member experience changes required to ensure its success, and launch it to market. Vancity funded the program as any new product would be and designed it to be financially sustainable. Its executives believe, based on their modelling, that these term loans can be profitable with an interest rate of 19% and an average loan amount of \$1,100. The profitability is tested annually as well as the progress that is being made to help these members break the cycle of debt and improve their credit so they are able to move into mainstream financial products. This is in line with CFSI's Strategy 4: "Design for success, not failure."

Alternatives to standard-term loans need to be considered—for example, the flex loan product introduced in Tennessee.

Example:

Through the Tennessee Department of Financial Institutions, a flex loan product has been developed that is really more like a small-dollar line of credit. A flex loan gives customers the ability to apply once and withdraw cash at any time up to the credit limit. Flex loans can be taken out in amounts from \$25 up to \$4,000.

With a flex loan, customers pay back the loan at their own pace, with conveniently scheduled payments. On loan due dates, customers have the option to pay only the minimum amount due or pay an additional amount so the balance can be reduced more quickly. There are never any late fees. As customers pay down their balance, they have access to borrowing additional cash up to their credit limit.⁷⁵ This could work for some customers and is aligned with CFSI's Strategy 5: "Offer borrowers choice and flexibility."

2

Engage Financial Institutions (con't)**PARTNERSHIP BETWEEN FINANCIAL INSTITUTION AND COMMUNITY PARTNER, WITH PHILANTHROPIC SUPPORT**

This model offers the community partner who is engaged in providing financial literacy education the opportunity to refer participants in their programs to a financial institution that is willing to provide small-dollar loans without the normal loan-approval process. This is in line with CFSI's Strategy 1: "Help borrowers build financial health by assisting them in paying down high-cost debt, building their credit, and accessing other opportunities to improve their financial well-being."

An underwriting process that allows the lender to effectively separate high-risk borrowers from low-risk borrowers is fundamental to a financial institution's ability to lend profitably at scale. At the same time, underwriting policies should be inclusive enough that traditionally underserved borrowers are able to access and successfully repay the loan as outlined in CFSI's Strategy 3: "Underwrite to balance inclusivity with risk." First Calgary Financial provides a clear example.

Example:

First Calgary Financial (FCF), a Calgary-based credit union serving Alberta communities for more than 75 years, is currently in the second phase of a pilot for the Cash Crunch loan, the purpose of which is to help those on a journey to financial wellness by paying off their payday loans or other existing collections and helping them to exit the cycle of payday lending. This program is a three-way partnership between FCF, Momentum, and a philanthropist. To support the pilot, the philanthropist has provided funding to be used by FCF to cover the cost of loans that default.

Cash Crunch is currently being offered by referral from Momentum to participants in their financial literacy programs. If the product were to move forward as a broader offering, marketing to existing customers would be their first priority, as was the case with the Vancity Fair & Fast loan. They would also continue to accept referrals from Momentum and other community organizations, but perhaps the requirement of being enrolled in financial literacy programming would be removed to streamline the referral process.

To ensure financial viability in the long run for a product similar to Cash Crunch without philanthropic support, it would be important to market the product line to a significantly greater number of consumers, to consider increasing the interest rate or fees charged, and to introduce technology solutions that would reduce delivery costs and streamline the application process. However, this would be viable only if the lender were to take on new processes to limit the expansion of fixed costs, such as by implementing new innovations in customer screening. This would be in line with CFSI's Strategy 6: "Streamline and automate to reduce costs and increase speed."

Another take on this type of partnership is a community-development credit union providing financial empowerment programming through non-profit organizations and then introducing graduates of the program to tailored financial products.

2

Engage Financial Institutions (con't)**Example:**

Neighborhood Trust is New York City's premier provider of financial-empowerment services. For more than 15 years this organization has integrated financial counselling and supports into settings and programs that low-income people trust, where financial supports are relevant, meaningful, and actionable. The "Getting Ahead" program is delivered via partnerships with leading non-profits, and graduates are granted access to a suite of socially responsible financial services.

Neighborhood Trust works with clients to build financial plans, change financial behaviour, and access socially responsible financial products included in the "Gateway Banking" package that encourages savings and debt reduction. Newly banked customers are introduced to a positive relationship with a mainstream financial institution through products including free savings and checking accounts at Neighborhood Trust (\$5.00 minimum deposit and free first check order; no minimum balance requirements; no monthly maintenance fees; and free online bill payment). Participants also receive a free customized financial plan, credit report analysis, and ongoing one-on-one financial counselling, as well as a 7% interest rate on a loan to help establish their credit.

*This Financial Empowerment Integration Model is now considered an industry best practice. It envisions a world in which relevant and effective financial services are integrated into people's everyday lives so that improved money management and financial mobility are the default outcome.*⁷⁰

BUILT-IN SAVINGS PROGRAM

Small-dollar credit can be designed so that a portion of the proceeds from the loan are placed in a savings account that can be accessed by the customer only after the loan is repaid. Customers are encouraged to continue making payments to their savings to improve their resiliency and reduce their need to borrow to cover expenses as they arise. Pennsylvania Credit Union Association's "Better Choice" program is an example of this.

Example:

There are 79 credit unions participating in the Pennsylvania Credit Union Association's Better Choice program, a smart alternative to payday loans. The Better Choice program offers loans from \$200 to \$500; 18% Annual Percentage Rate (APR); 90-day repayment term; flexible monthly, biweekly, or weekly payments; a \$20 application fee; and the loan is topped up by 10% and that amount is automatically deposited into a savings account and cannot be withdrawn until the loan is repaid. Optional financial counselling is offered to customers as part of the support for their success in improving their credit. This is in line with CFSI's Strategy 1: "Help borrowers build financial health."

The Better Choice loan is intended to break even, and losses on the loans are relatively low, ranging from 5 to 6%. To induce credit unions throughout the state to offer Better Choice loans, the Pennsylvania Treasury reimburses losses up to 50%. The Pennsylvania Credit Union Association in partnership with the Pennsylvania Treasury Department and the Pennsylvania Department of Banking sponsors the Credit Union Better Choice program.

Each financial institution will need to decide what service offerings best meet the needs of their customers; however, we have included financial modelling that can be used as a starting point for discussions. The two primary products that we recommend are the financial institution vulnerable populations product and the financial institution mainstream product.

2

Engage Financial Institutions (con't)**Tactic 1: Financial Institution Targeted Loan Product**

While these loans should be granted through existing financial institutions, including credit unions, provincial FIs, possibly even emerging FinTech and socially conscious existing payday lenders, 100% of the clients granted a loan should be referred by an approved community economic development organization or social service agency. These agencies will confirm that the recipient is one who fits their charitable mandate and will ensure that a financial literacy action plan is formulated. These customers will generally be employed but living below or near to the poverty line, and will be experiencing sporadic cash-flow shortfalls due to unexpected expenses or timing issues such as getting a bonus in two months but needing car repairs now. They can be expected to meet ongoing obligations based on their debt service ratio being below 50% (including housing costs) and may have a damaged credit history (credit scores between 550 and 600). With philanthropic support for some programming costs and loan losses, financial institutions can turn these clients into profitable connections over time. See Appendix 1 for details on the type and amount of financial support we recommend for program costs, marketing and loan loss support.

Tactic 2: Financial Institution Near Mainstream Loan Product

These loans should also be granted through existing financial institutions, including credit unions, provincial FIs, possibly even emerging FinTech and socially conscious existing payday lenders. However, unlike when targeting more vulnerable customers, these loans will not require an agency referral nor will they have a mandated financial literacy program, other than advice delivered by the FI itself. These customers will always be employed, be experiencing sporadic cash-flow shortfalls due to unexpected expenses or timing issues (e.g., getting a bonus in two months but needing car repairs now), can be expected to meet ongoing obligations (debt service ratio below 50%, including housing costs), and may be just below general FI lending guidelines for credit history (credit scores between 600 and 660). A small amount of support for loan losses from the philanthropic community can have a large social multiplier in reduced borrowing costs and an accelerated return to mainstream financial inclusion. See Appendix 1 for details on the type and amount of financial support we recommend for program costs, marketing and loan loss support.

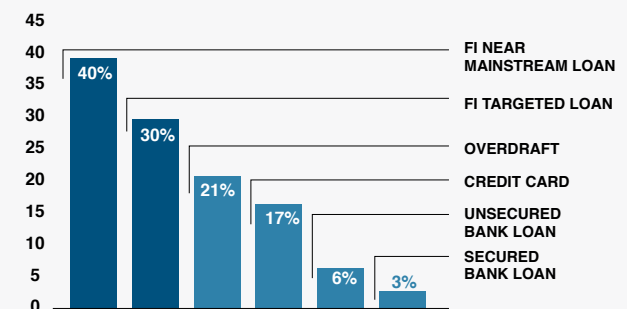
Suggested loan terms and conditions for both offerings provided through financial institutions have been included below.

	FI Targeted Loan	FI Near Mainstream Loan
Terms		
Loan Minimum	\$200	\$500
Loan Maximum	\$1,000	\$1,500
Set-up Fee	\$25	\$50
Interest Rate	29.9%	39.9%
Standard length of loan	8 months	12 months
Repayable without penalty	Yes	Yes

Conditions

Max Debt Service Ratio	50%	50%
Minimum Credit Score	550	600
Special	Referral	None
Max # of loans/year	2	3

While the rates used in these models may still seem high to some readers, it is important to understand that these products are not intended to be the final “home” for small-dollar credit users. Rather, they are an achievable first step for customers in meeting their current financial needs, building a constructive relationship with a financial institution, and moving toward fully mainstream credit products that are not supported by philanthropic dollars.

Consumer Credit - Rate Continuum

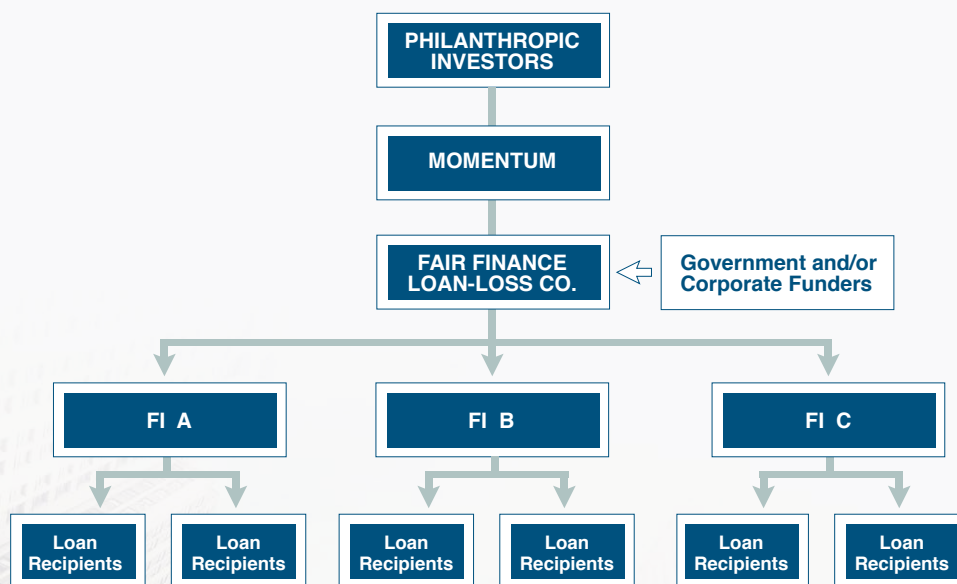
The modelling tool provided with this report can be used to simulate changes to the various attributes, allowing customization for different lenders. Credit Unions are an important potential partner for these products, given their history as unique depository institutions created to serve their members as credit cooperatives in Alberta since 1938.

2

Engage Financial Institutions (con't)***Tactic 3: Funding and Financial Support***

Financial support for product development and delivery should be made available to all industry players including emerging FinTech companies, existing payday-loan companies (that agree to design more customer-enabling products), and companies already serving the small-dollar credit customer demographic—for example, Walmart and/or 7-11 in addition to traditional financial institutions. By engaging all these players, the goal of serving customers how and when they want to be served will be honoured.

Funding could come from a variety of sources—government, corporations, and philanthropists—and could be overseen by Momentum or a similar charitable organization through a wholly owned subsidiary. The wholly owned subsidiary would be responsible for dispersing the funding to the lending organizations to cover loan losses at the agreed-upon level. A draft structure is presented below.

LOAN LOSS FUND POOL

See Appendix 1 for details on the type and amount of financial support we recommend for program costs, marketing and loan loss support.

3

Alternatives Not Involving Financial Institutions

While a significant portion of small-dollar credit can be provided by financial institutions, we believe there is also a role for other providers to play. When multiple players participate, customers have choice, while responsibility and risk are shared. We offer examples of other ways of delivering small-dollar credit that are already working in other places that we believe could benefit Albertans.

Tactic 1: Employer Benefit – Payroll Deduction

One way of providing small-dollar credit effectively is as an employee benefit through employers. The program can be set up with little underwriting, as the employer is committing to deducting the payments from the employee's pay. It is convenient for the employee because it can be accessed easily and at a reasonable cost.

Example:

In Calgary, ZayZoon is launching a unique technology-based solution. ZayZoon is designed with the needs of employers and employees in mind. Employers offer this service as an employee benefit. Employees have an inexpensive, easy, and secure way of borrowing against their next pay cheque for significantly less than the cost of a traditional payday loan.

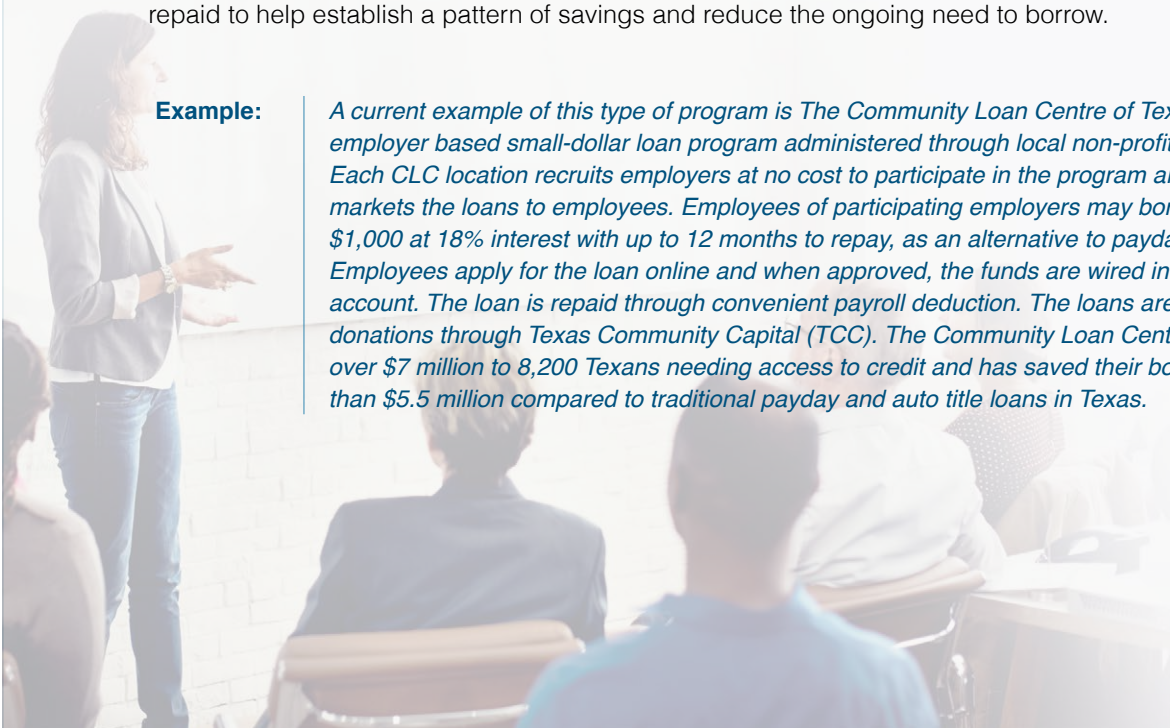
Tactic 2: Mini Loan and Savings Program with Financial Coaching Through Community Lending Centre

The goal of this program is to help people who acknowledge they need help to improve their credit score and financial health. Alternate eligibility for loans would include looking at the stability of the customer's housing, employment, and other indicators, such as the customer's motivation to improve his or her financial health. Ability to repay based on income, expenses, and other debt would be confirmed prior to lending money that the customer may not be able to repay.

The purpose of the loan matters, and payment should be made directly to the recipient of the loan proceeds, as opposed to giving cash to the customer. Financial coaching should be a mandatory part of the program, and a portion of the loan amount is put into a savings account and held until the loan is repaid to help establish a pattern of savings and reduce the ongoing need to borrow.

Example:

A current example of this type of program is The Community Loan Centre of Texas' has an employer based small-dollar loan program administered through local non-profits in Texas. Each CLC location recruits employers at no cost to participate in the program and the CLC markets the loans to employees. Employees of participating employers may borrow up to \$1,000 at 18% interest with up to 12 months to repay, as an alternative to payday loans. Employees apply for the loan online and when approved, the funds are wired into their bank account. The loan is repaid through convenient payroll deduction. The loans are funded by donations through Texas Community Capital (TCC). The Community Loan Center has lent over \$7 million to 8,200 Texans needing access to credit and has saved their borrowers more than \$5.5 million compared to traditional payday and auto title loans in Texas.



3

Alternatives Not Involving Financial Institutions (con't)**Tactic 3: Refer to Online Provider**

This is another alternative for community organizations involved in leveraging technology and designing financial services for everyday life. The organization can develop loans in such a way that some customers would want to borrow online. Convenience, transparency, and simplicity are valued by many customers. Especially for younger borrowers who are comfortable transacting on the computer or through their phone, this could be a viable option. If financial tips and information could be provided through the website, the borrower's financial understanding and confidence could be improved.

Two options exist that allow community organizations to access an online platform. First, an online partner like Mogo could take referrals on a revenue-share basis—for example, as a percentage of the loan up to a certain cap—which would provide a small cash flow to the community organization. Or, the community organizations with funding from investors or philanthropists could use the platform on a white-label basis (i.e., the customer would interact with the platform branded for the community organization) for underwriting of the loan. The loan would actually be funded through backing by philanthropic funding pool. This option would allow community organizations an inexpensive and effective screening and monitoring tool that could also help to identify both interest rates and loan terms that would be best suited to the customer.

Example:

Since launching its first online loan product in 2006, Mogo has become the leading online lender in Canada, with over 1 million loans originated. It is the only full-credit-spectrum lender, featuring an ever-expanding portfolio of innovative and socially responsible financial solutions, including the unique “Level Up” program that rewards customers for repayment as agreed by reducing their rates periodically, and providing interest rates that are significantly lower than other small-dollar loan providers. Mogo will soon be introducing a free Mogo Prepaid Visa card, which could be a useful tool for this customer demographic.⁷¹

The organization can develop loans in such a way that
some customers would want to borrow online.



4

Serving the Most Vulnerable Customers, and Referrals to a Wider Range of Providers

While it is clear that the most vulnerable clients (such as recipients of AISH, OAS, and Alberta Income Support) most often are placed in a more precarious situation by taking on debt, the legitimate need for short-term cash-flow bridging still exists. Repeatedly in focus groups with representatives of these segments, it was brought forth that community organizations themselves are the source that these customers want to turn to. Existing relationships with these clients have already been established, or can be forged; and community organizations can address the much wider spectrum of needs these clients may be facing, including debt counselling, food-bank referrals, and intensive financial coaching.

Community organizations
are the source that
the most vulnerable clients
want to turn to.

Delivered by existing community economic development organizations and social services agencies to their most vulnerable populations, a lending product that is appropriate for these customers needs to give them a very flexible repayment schedule at no extra cost (e.g., no fee, no interest). Even with these loan characteristics, many of the loans will not be repaid. Significant time will need to be spent with each client providing one-on-one financial counselling, making this an expensive population to support. Product parameters that were vetted with focus groups included:

Compassionate Loan

Terms

Loan Minimum	\$200
Loan Maximum	\$750
Set-up Fee	-
Interest Rate	0%
Standard length of loan	10% of income
Repayable without penalty	Yes

Conditions

Max Debt Service Ratio	N/A
Minimum Credit Score	550
Special	Active Case
Max # of loans/year	1

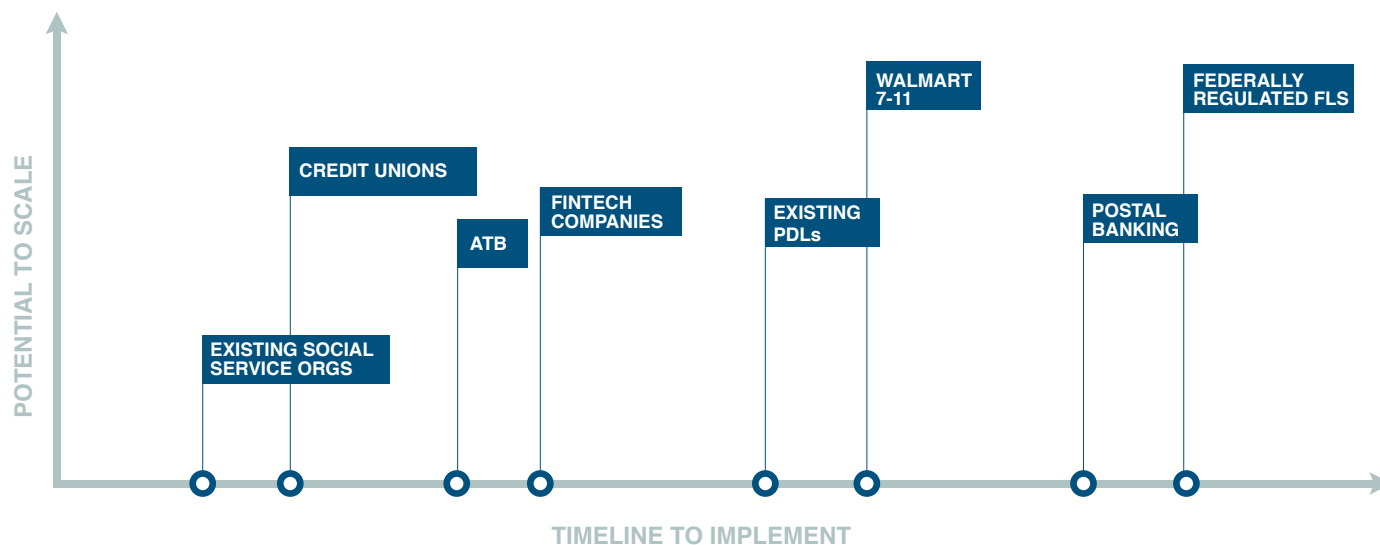
The Desjardins Mutual Assistance Fund, mentioned earlier in this report, is a working example of how philanthropic funds can be leveraged to provide a higher Social Return on Investment by amplifying excellent work already done by community organizations. Community partners would also look to incorporate technology solutions, such as Mogo's application platform described above, as part of supporting customers in this segment.



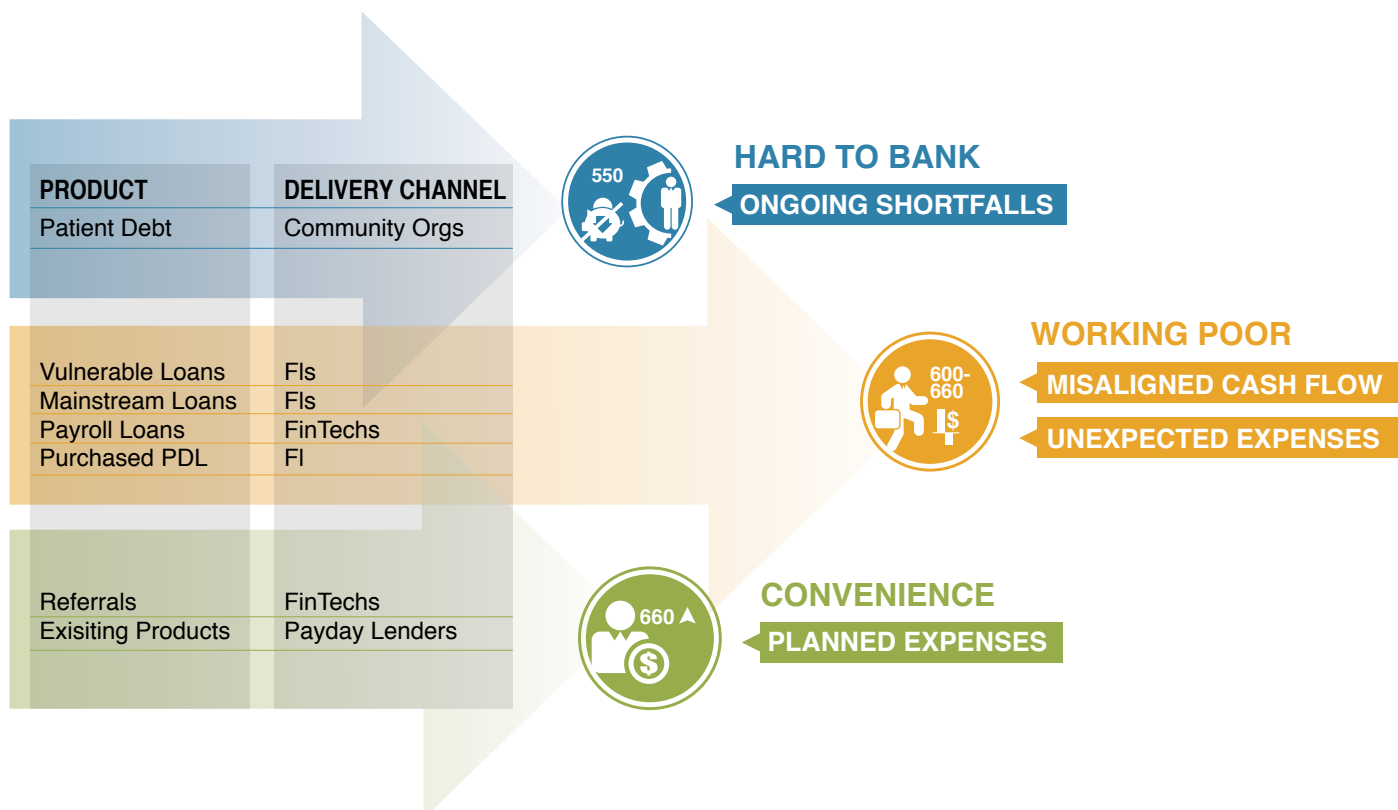
Recommendations Summary

We see the alternatives available to meet the needs of the unbanked and underbanked in Alberta as being a portfolio of answers with roles for a number of players including government, investors, philanthropists, financial institutions, community-based lenders, employers, social enterprise and select retailers, with modification of the business model, payday lenders. Not all these players will have the same time to market, or potential to scale, but we believe there is opportunity for all to participate in making small-dollar credit available in a safe and responsible way.

DELIVERY CHANNELS



RECOMMENDATIONS BY CUSTOMER SEGMENT



Implementation and Conclusions

This agenda needs to be moved forward now. All the key stakeholder groups have invested significant time, money, and energy into the issue, while concrete actions often seem to waver. In addition, as noted previously, the various stakeholder groups could significantly benefit from a much more robust and inclusive working group.

It is our opinion that despite significant efforts from a number of stakeholders, the current state of the payday-lending debate has reached an unhealthy impasse. Key stakeholders including government, philanthropists, existing payday lenders, and emerging FinTech and mainstream providers to this demographic (i.e., Walmart and 7-11) have taken very polarized and often secretive positions, which has significantly slowed constructive movement toward a better customer experience. The complexity of the issues and the polarization of the stakeholders have reached a point where support for a dedicated implementation position, not beholden to any stakeholder group, is necessary to reignite a collaborative conversation. Estimated expenses for the creation of such a role have been included in our financial modelling.

This agenda needs to be moved forward now. All the key stakeholder groups have invested significant time, money, and energy into the issue.

KEY DELIVERABLES WOULD INCLUDE:

- Facilitation of more wide-ranging taskforces on the issue including all stakeholders
- Creation and management of a clearinghouse of best practices and industry insights amongst all stakeholders
- Overseeing of implementation research and impact measurement where possible
- Support for marketing of payday-loan alternatives

Specifically:

- Engage highly in the provincial regulatory discussion on the new Act to End Predatory Lending
- Engage with existing payday lenders to share global best practices on the move to a multiline product model
- Engage with new market entrants (FinTechs, existing segment providers such as Walmart, 7-11) to work through how communities and regulators can support enhanced products with better social value
- Engage with the federal regulators in regard to two key players, the federally regulated banks and the post office, for inclusion in the provision of small-dollar credit
- Take the loan-pooling initiative forward, arranging funding and building out the legal framework
- Act as a consultant to Alberta financial institutions such as First Calgary Financial, Servus Credit Union, and ATB Financial as they continue to move forward to better serve the small-dollar credit market.

CONCLUSIONS

Work Smart. Learn Fast.

We make the above recommendations toward providing a framework for accelerating innovation in small-dollar credit in Alberta. While products are important to such an innovation being successful, *accelerating* this innovation will require an implementation plan that is thought through, measured, and evaluated with an informed eye. Importantly, truly understanding the personal, social and economic results of the interventions described here requires looking not just at results at the end of a rollout, but also planning metrics and access to data in advance, engaging in thoughtful ongoing testing of both assumptions and performance, and ensuring that it is not just outcomes that are tracked, but also impact. Such a process will ensure that it is not just *accelerated* innovation that is achieved, but also *effective* innovation.

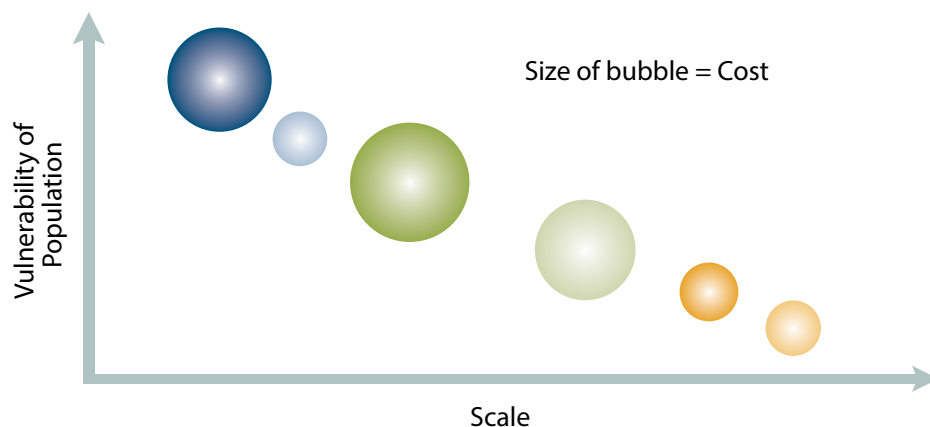
Reaching the goals that Momentum has placed before us, including scale, sustainability, and financial inclusion, will require financial support to turn research into on-the-ground reality. The three year financial support will be used to accelerate innovation within the financial services sector including both program and loan loss support. As mentioned previously, various players including all three levels of government, private individuals, foundations, and corporations have a big stake in taking the provision of small-dollar credit to its next logical step.

There is much to be done and it seems the time is right, with the government's current intention to make changes to the provincial regulations, to work collectively to provide real solutions for unbanked and underbanked Albertans.

PHILANTHROPIC SUPPORT OPPORTUNITIES

DOLLARS NEEDED

COMPASSIONATE LOAN PROGRAM	
COMPASSIONATE LOAN CAPITAL	
FI TARGETED	
FI NEAR MAINSTREAM	
GOVERNMENT ADVOCACY	
PRIVATE SECTOR ADVOCACY	



List of Interviewees

This report draws on the experiences and insights of leaders and experts from for-profit and non-profit organizations in Canada, the USA, and the UK, as well as those who supported this work anonymously as research participants. The individuals listed below generously shared their time in interviews conducted between January 2016 and March 2016:

Dave Baker

President, Newstart Canada

Jane Bisbee

Executive Director, Social Enterprise Fund

Norman Bishop

Barrister & Solicitor, Bishop & McKenzie LLP

Teri Buckley

Community Brand Manager,
ConnectFirst Credit Union

David Chen

President & CEO, Blue Copper Capital

Ray DePaul

Director,
Institute for Innovation and Entrepreneurship
Mount Royal University

Brian Dijkema

Program Director, Work and Economics
Cardus

Jacob DuMez

Manager, Policy and Programs
San Francisco Office of Financial
Empowerment City and County of
San Francisco

Annie Farnsworth

Board Member, More Than Wheels

Ricky Floyd

Vice President, Operations
NIX Neighborhood Lending

Thea Garon

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Centre for Financial Services Innovation

Mike Gruber

Fintech Business Development and Partner
Leader
Mogo

Tate Hackert

CEO, ZayZoon

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Public Policy Manager, Momentum

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Professor, CMA Alberta Faculty Fellow
Haskayne School of Business
University of Calgary

Sandra Huculak

Managing Director, Corporate Social
Responsibility & Community Investment
ATB Financial

Alison Karim-McSwiney, BA, MIPM

Executive Director, International Avenue BRZ

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United Way of Calgary and Area

Linda Kaszuba

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First Calgary Financial

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Centre for Financial Services Innovation

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CEO, Cashco Financial

Jamie Leong Huxley

Strategy and Communication, Zinc Ventures

Brian Liu

Manager, Member Solutions
Vancity

Tracey Livingstone

Program Manager,
Sunrise Community Link Resource Center

Erin Melnychuk

Business Development Manager,
Momentum

France Michaud

Communications Supervisor,
Développement international Desjardins

Marcia Nozick

Executive Director, Embers Staffing Solutions

Michael Olson

Research and Policy Office, Education,
Research and Policy Division
Financial Consumer Agency of Canada (FCAC)

Brenton Peck

Relationship Manager,
Centre for Financial Services Innovation

Luis Peralta

President, NIX Neighborhood Lending

Andrea Robertson

Vice President, TD Wealth

Carlen Scheyk

Financial Literacy Facilitator, Momentum

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ConnectFirst Credit Union

Adrian Shorter

Product & Innovation Manager,
ConnectFirst Credit Union

Troy Tisserand

Managing Partner, 4 Pillars Consulting Group

Darcy Tuer

Entrepreneur, ZayZoon

Eva Wong

Chief Operating Officer, Borrowell

Karen Young

Chief Operating Officer,
United Way of Calgary and Area

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ORGANIZATION	WEBSITE
Asset Platform	www.Assetplatform.org
Bank On - Payday Plus Program	http://www.joinbankon.org
Bank Plus - Credit Plus	https://www.bankplus.net/CreditPlus/
Barclays	https://www.home.barclays/citizenship/citizenship-in-action/banking-on-change.html
Blue Copper Capital Corporation	http://bluecoppercapital.com/
Borrowell	https://www.borrowell.com/
Cashco Financial	https://cashcofinancial.com/
Centre for Financial Services Innovation	http://www.cfsinnovation.com
Churches Mutual Credit Union	http://cmcu.org.uk/
CoVantage Credit Union	https://www.covantagecu.org/
Desjardins Mutual Assistance Funds	https://www.desjardins.com/ca/about-us/social-responsibility-cooperation/socially-responsible-products-services/solidarity-based-finance/index.jsp
E-Duction	www.e-duction.com
Elevate - RISE	https://www.elevate.com/products.html
Enova	https://www.enova.com/
FDIC - Small Dollar Loan Project	www.fdic.gov/smalldollarloans
Kinecta	https://www.kinecta.org/ http://nixlending.com
Liberty Bank and Trust Company	http://www.libertybank.net/
Mogo	https://www.mogo.ca/about-mogo
Montana Credit Unions for Community Development	http://www.montanacreditunions.coop/
More Than Wheels	http://www.morethanwheels.org/
National Australia Bank	http://www.nab.com.au/personal/help-and-guidance/financial-difficulty
NewStart Canada	http://www.newstartatlantic.com/
Ohio Credit Union League-Stretch Pay	http://www.ohiocreditunions.org/stretchpay.htm
Oportun	http://www.oportun.com/
Opportunity Financial	https://www.opploans.com/
Options Consummateurs	http://www.option-consommateurs.org/en/
Pennsylvania Credit Union Association-Better Choice program	https://pcua.org/ConsumerInfo/BetterChoice.aspx
State Employees Credit Union-Salary Advance Loan	www.ncsecu.org
VanCity Fair & Fast Loan	https://www.vancity.com/Loans/TypesOfLoans/FairAndFastLoan/
Virginia Credit Union-VSELP	http://www.cvc.virginia.gov/vaemploan/faqs.html
Wilmington Trust	http://wilmingtontrust.com/repositories/wtc_sitecontent/PopUp_Content/2007/PR-2007-1015_west_end.html
Zestcash	https://www.zestcash.com/

FINTECH COMPANIES

Ascend Consumer Finance	www.ascendloan.com
Backbase	http://www.backbase.com/
Betterment	https://www.betterment.com/
Borrowell	www.borrowell.com/
CircleBank Lending	https://www.circlebacklending.com/
Cumulus Funding	http://cumulusfunding.com
Cyberport	www.cyberport.hk
FundThrough	www.fundthrough.com
Grouplend - GROW	https://poweredbygrow.com/
Jumio Inc	www.jumio.com
Lendified	www.lendified.com
Lending Club	https://www.lendingclub.com/
Lending Loop	www.lendingloop.ca
Lending Tree	https://www.lendingtree.com/
LexisNexis RiskSolutions	http://www.lexisnexis.com/risk/about/
Manifold Technology	www.manifoldtechnology.com
MaRS Discovery District	www.marsdd.com/fintech
Moven	www.moven.com
Nutmeg	https://www.nutmeg.com/
Paym	www.paym.co.uk
Pingit	www.pingit.com
Prosper Marketplace Inc.	https://www.prosper.com/
Puddle	https://www.puddle.com/
SavvyMoney	https://www.savvymoney.com/
SEQR	www.seqr.com/
Square	https://squareup.com/ca
Tangerine	www.tangerine.ca
Thinking Capital	www.thinkingcapital.ca
ZAYZOOM	www.zayzoon.com
	www.ascendloan.com

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Appendix 1: Financial Modelling

FINANCIAL INSTITUTION PRODUCT CHARACTERISTICS

	Compassionate	Targeted	Near Mainstream
Minimum	\$200	\$200	\$500
Maximum	\$750	\$1,000	\$1,500
Set up Fee	Zero	\$25	\$50
Rate	Zero	29.9%	39.9%
Length	10% Income	8 Months	12 Months
Debt Ratio	N/A	50%	50%
Credit Score	550	550	600
Conditions	Active Case	Referral	None
Loans/year	1	2	3
Average Loan	400	400	600
Loss Ratio	50%	30%	20%
Loans/Client	1	1.2	1.3
Average Term	12	6	9

FINANCIAL SUPPORT OVER THREE YEARS FOR FI PRODUCTS

	Compassionate	Targeted	Near Mainstream
Initial Capital	\$480,000	FI provides	FI Provides
Program Costs	\$2,466,000	\$637,500	\$300,000
Loan Losses	\$648,000	\$1,200,000	\$1,800,000
TOTAL	\$3,594,000	\$1,837,500	\$2,100,000
# Loans	3,600	10,000	15,000
\$ Loans	\$1,080,000	\$4,000,000	\$9,000,000
Direct Impact	\$3,691,000	\$4,508,424	\$17,880,452
Vulnerability Multiplier	7	2	1
Social ROI	1.55	3.58	7.51
Charitable Eligibility	Charitable Support	Charitable Support	Government Support

FI PRODUCT SUSTAINABILITY AFTER 3 YEARS?

OPERATIONAL COST



LOAN LOSS

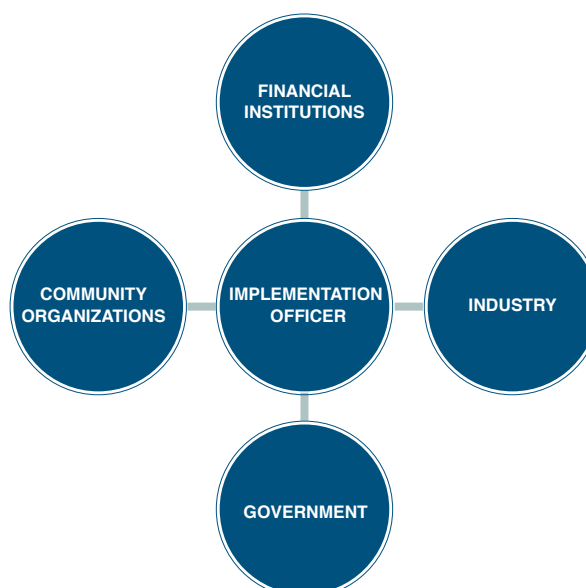
RATE

Sustainable Rate without Support

Targeted110%
Near Mainstream92%

Cost Control Measures

Fintech loan origination tools
Alternate credit adjudication



Implementation

- Non Partisan Taskforce
- Curate Best Practices
- Measurement & Evaluation
- Marketing New Products/ Resu
- \$360,000 (3 years)

Appendix 2: Financial Support for Loan Loss Examples

FINANCIAL SUPPORT OVER THREE YEARS FOR FI PRODUCTS

Several existing small-dollar credit programs have access to loan loss reserves or linked, low-cost deposits provided by government bodies or philanthropic groups. These guarantees provide important incentives to financial institutions looking to provide small-dollar credit but hesitant due to concern about the cost of doing so. Examples include:

The Better Choice program offered through the Pennsylvania Credit Union Association is backed by a loan guarantee program funded by the Pennsylvania State Treasurers' Department. \$20 million in state operating funds are deposited in a corporate federal credit union and receive a market rate of return. The spread is used to fund the loan loss reserve pool. Participating credit unions can apply to the pool to have up to 50 percent of their losses offset. In addition, the Pennsylvania Credit Union Association helps offset the cost of entry into small-dollar lending by paying for traditional advertising for credit unions that wish to enroll in the Better Choice Program.

Desjardins partners with local community organizations that provide financial counselling and where appropriate refer members to the local caisse populaire to fund their small-dollar interest-free loans. Desjardins commits significant corporate community investment funding to both the community partners for financial counselling programs and to the caisse populaire to cover loan losses incurred through this program.

Wilmington Trust in Delaware originates small-dollar loans solely to clients of West End Neighborhood House (WENH), a non-profit organization. WENH screens applications, performs loan underwriting based on the bank-approved criteria, and provides a full range of counseling and other services for prospective borrowers. All of the loans are fully guaranteed by WENH and backed by a loan loss reserve funding by grants and donation from other program partners.

As it is recommended that financial institutions tailor offerings to their organizational capacity and needs of their customers, loan loss support could be made available to financial institutions for small-dollar credit product offerings that meet certain minimum specifications

Appendix 3: Possible Phased Approach to Implementation

YEAR ONE	YEAR TWO	YEAR THREE
FI TARGETED PRODUCT		
Expand # of Cash Crunch Loans Add one or more FI every 6 months <ul style="list-style-type: none"> Funding starts with charitable \$ Phases over to Government support in years two and three 	FI NEAR MAINSTREAM PRODUCT	
	Implement at First Calgary Implement at ATB Start discussions with AB Central to expand to other CUs <ul style="list-style-type: none"> Government financial support for this program makes the most sense 	COMPASSIONATE PRODUCT Implement at Momentum and Sunrise on a pilot basis Prove the impact with solid M&E <ul style="list-style-type: none"> Fund with charitable \$ initially, moving to government support if the M&E proves that clients move to the other two programs over time

Product	Investment Type	Year One	Year Two	Year Three
Targeted	Program Loan Loss	\$127,500 \$240,000		
Targeted	Program Loan Loss		\$191,250 \$360,000	
Near Mainstream	Program Loan Loss		\$40,000 \$240,000	
Targeted	Program Loan Loss			\$318,500 \$600,000
Near Mainstream	Program Loan Loss			\$100,000 \$600,000
Compassionate	Program Loan Loss			\$518,000 \$160,000
TOTAL CHARITABLE		\$367,500	ZERO	\$678,000
TOTAL GOVERNMENT		ZERO	\$831,000	\$1,618,500