The Promise of Small-Dollar Loans for Banks and Consumers

Lois Aryee • Tahan Menon
Kate Rinehart-Smit • Evelyn Stark

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About ideas42

ideas42 is a nonprofit that applies insights from behavioral science—the study of how people make decisions and act in the real world—to improve lives and drive social change. Working globally, we reinvent the practices of institutions, and create more effective products and policies that can be scaled for maximum impact.

We also teach others, ultimately striving for a future where the universal application of behavioral science powers a world with optimal health, equitable wealth, and environments and systems that are sustainable and just for all.

For the past 15 years, we've been at the forefront of applying behavioral science to create a more equitable world. And as we've developed our expertise, we've helped to define an entire field. Our efforts have so far extended to 50+ countries as we've partnered with hundreds of governments, foundations, NGOs, private sector entities, and philanthropic leaders.

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The Promise of Small-Dollar Loans for Banks and Consumers

A recent Federal Reserve survey vividly demonstrates the struggle American households face when handling shocks to their income or expenses. The data shows that nearly 20% of adults would find it difficult to manage an unexpected $100 expense with their savings alone. Such shortfalls can translate into families eating less, suffering cold homes, or delaying medical care. When people inevitably experience these shortfalls, they deserve access to affordable, convenient, and quick credit options to manage their short-term borrowing needs.

However, for up to 50 million Americans without credit files and for many others with low credit scores, affordable borrowing options are frequently out of reach. Many consumers instead turn to alternative financial services, such as payday or auto-title loans, which come with exorbitant prices and balloon payments that frequently worsen an already difficult financial situation.

In search of better options, Americans are increasingly able to access small-dollar loan offerings from large banks, credit unions, and community banks. These products are generally short-term installment loans or lines of credit, which leverage cash flow underwriting and relationship history to increase access to credit for a wider cross section of consumers. Among other benefits, bank-offered small-dollar loans are much less expensive than payday loans and come with payments spread over several months that consume just a small share of a borrower's income.

Small-dollar loans are providing benefits not only for consumers but also for banking institutions who can tap into a large and reliable market. Banks are starting to report robust results and are exceeding expectations around uptake and performance. Despite this encouraging momentum, there are still many consumers who need access to small-dollar loans and more providers that can benefit from launching a product.

ideas42, with support from The Pew Charitable Trusts, interviewed banks, regulators, researchers, advocates, and small-dollar loan borrowers to learn about the customer experience and the barriers, drivers, and opportunities in the small-dollar lending space.[i] ideas42 was able to reach bank-offered small-dollar loan borrowers through a partnership with SaverLife,[ii] a nonprofit that helps members improve their financial health.

[i] ideas42 spoke to 13 stakeholders and market participants, including leading banks, regulators, think tanks, and advocacy organizations between April and September 2023. In addition, ideas42 conducted qualitative research with 10 small-dollar loan borrowers with loans from four major U.S. banks in September and October 2023. While borrowers vary by race, age, location, and other characteristics, they are not necessarily representative of the full population of small-dollar loan users.

[ii] SaverLife is a national nonprofit and advocacy organization using technology to improve the financial health and well-being of people living on low-to-moderate incomes.

Growth in the Small-Dollar Loan Market

As recently as five years ago, financial institutions faced a challenging environment for developing and offering small-dollar loans. Little was known about the potentially high repayment risks attached to lending to this market, while much concern focused on the significant expense of creating and launching a new product, including technology development and maintenance. Banks were further discouraged by a lack of regulatory clarity that could incur additional costs or imperil a product altogether. A Government Accountability Office report detailed that between 2010 and 2019, regulators issued or rescinded at least 19 actions related to small-dollar loans.

Today, the prospects for small-dollar loans have changed considerably. Currently, six of the eight largest banks have a small-dollar loan or line of credit, while similar offerings at smaller banks and credit unions are also growing. National attention to historically underserved communities, and developments in regulation and technology were crucial for shifting the landscape.

The 2020 Interagency Lending Principles, from the FDIC, Federal Reserve, Office of the Comptroller of the Currency, and National Credit Union Administration, recognized the importance of small-dollar loans and highlighted principles that would characterize responsible lending, including alternative underwriting and discouraging rollovers. Similarly, the CFPB has not expressed concern with small-dollar loans that banks offer directly to their existing customers. With five financial regulators broadly in favor of such small-dollar loans, providers have the regulatory stability to develop and launch these products. Evidence of the impact of this regulation is seen in a recent empirical assessment at the Federal Reserve, where at least a 3% increase in small-dollar lending activity over a brief period of time was attributed to the interagency guidance.

TABLE 1: FEATURES OF MAJOR U.S. BANKS' SMALL-DOLLAR LOAN PRODUCTS

Bank	Product	Year Introduced	Loan Size	Payment Structure	Pricing
usbank	**Simple Loan**	2018	$100 - $1,000	3 equal monthly payments	$6 per 100
BANK OF AMERICA	**Balance Assist**	2020	$100 - $500	3 equal monthly payments	$5 flat fee
Huntington Bank	**Standby Cash**	2021	$100 - $500	3 equal monthly payments	5% flat fee per advance
REGIONS	**Protection Line of Credit**	2022	$50 - $500	Minimum payment of 10% of outstanding balance	12% APR
TRUIST	**Cash Reserve**	2022	$5 - $750	4 equal monthly payments	18% APR
WELLS FARGO	**Flex Loan**	2022	$250 - $500	4 equal monthly payments	$12 - $20 flat fee

Sources: ideas42 compilation of publicly available information from bank websites and news releases as of February 2024

Given this regulatory clarity, banks also feel secure enough to make the necessary tweaks to improve their loan programs. Bank of America, for instance, changed their policies around reborrowing from a 30-day cooling-off period to a cap of six loans in a rolling 12-month period. This change helped borrowers avoid payday lenders during cooling-off periods, while still discouraging borrowers from repeatedly pre-paying three-month installments loans to quickly re-borrow. Similarly, Huntington Bank recently announced a change in pricing, moving from a mostly free product to a 5% flat fee per advance, in a bid to better achieve product sustainability and expand credit access to more of their checking account customers.

In conversations with bank stakeholders, providers acknowledged that technology developments are enabling the introduction of small-dollar loans. The widespread adoption of cash flow underwriting, automation (from origination to repayment), and digital banking tools enabled providers to reduce unit costs and to affordably and accurately assess repayment ability in lieu of credit scores.[iii] These developments ensured that loan programs were financially sustainable for the provider and affordable for the consumer, paving the way for entry into the market.

Providers experience healthy uptake and loan performance

Banks with small-dollar loans have been encouraged by product outcomes, citing growing scale, repayment behavior, and customer satisfaction as highlights. Providers, whether they are banks or credit unions, are seeing robust consumer uptake. For instance, credit unions broke records for small-dollar loan volumes in 2022, originating over $227 million, 30% more than the previous annual high mark. NCUA reporting also shows that the volume of lending under the Payday Alternative Loan program used by some federal credit unions has set an all-time high eight quarters in a row. Among major banks, Wells Fargo announced on their first-quarter 2023 earnings call that they had issued over 100,000 Flex loans five months after introducing the product. Meanwhile, Bank of America announced in November 2023 that they have disbursed over $500 million and over 1.1 million Balance Assist loans since their product launched in December 2020.

Interviews with leading banks' product managers noted encouraging repayment behavior and lower loss ratios than initially anticipated. One provider found repayment rates of above 95%, while other providers mentioned that their loss ratios were significantly lower than pre-launch expectations, in part due to autopay. Providers mentioned the value borrowers place on maintaining access to the product in anticipation of future emergencies as one reason for healthy repayment behavior—a theme that was echoed by the borrowers we interviewed.

Small-dollar loans were also seen as a tool to enhance longer-term customer engagement and grow opportunities to serve customers with other bank products. One provider shared that their small-dollar loan is the highest cross-sell related to their checking account. Likewise, providers noted the goodwill created by offering the product. Customers, during our interviews, confirmed this sentiment, feeling that they were getting more service from their banks in return for their customer deposits and were more appreciative of their banks after taking out a loan.

[iii] As of February 2024, only two of the six major banks run a hard credit check for their small-dollar loan credit approvals.

Bank providers have, to date, found that they are able to make a business case for serving a broad section of consumers, and are increasingly sharing their successes, which may encourage new entrants looking to serve families living with low and moderate incomes. In general, banks without a small-dollar loan would benefit from the availability of public information on borrower outcomes related to small-dollar loans, especially given the limited availability of information currently. To begin to fill this knowledge gap, ideas42 identified promising findings from qualitative research on the experiences of borrowers who recently accessed bank-offered small-dollar loans..

Borrowers appreciate customer experience and utility of small-dollar loans

ideas42 partnered with SaverLife to identify and connect with their members who have used bank-offered small-dollar loans in the last 12 months. We spoke to 10 borrowers who almost uniformly had positive views based on the customer experience, ease of application and repayment, and the benefits relative to alternatives.

Borrowers described the digital applications as "pretty straightforward" and "much easier" than expected. Fast approvals and funding, which took anywhere from a few minutes to the same day, also garnered positive reviews. In general, borrowers found the funding process less stressful than alternative credit options. One borrower summed up their overall experience in the following way: "I was like, wow, that's simple."

The borrowers we spoke to found repayment manageable due to the affordability and structure of loans. The six major banks charge fee-inclusive rates of 36% or lower, equating to dollar costs of about one-fifteenth of typical payday loan pricing. Borrowers also appreciated the repayment terms, usually 3 or 4 equal monthly payments, which ensured that budgets were not stretched too thin and large payments did not induce expensive rollovers. On average, monthly payments for a $500 loan ranged between $51 and $177. Repayment was also manageable because borrowers felt that the limited loan sizes prevented them from borrowing more than they needed. For many borrower needs, loan amounts were sufficient to meet their obligations while preventing borrowers from accumulating unnecessary debt during moments of financial distress.

"With the **overdraft experience, it's stressful.** With the [small-dollar loan], it was just [an] easy process. I didn't have as much stress. It was easy and I would rather to do that than be part of overdraft."

"With the **payday loan, you got to go in, they're verifying everything.** They're literally calling your employer, digging up pay stubs ... as opposed to basically filling in your information that's already readily available and then just waiting for the funds to hit [with the small-dollar loan]."

"If you borrow from family, it's like okay, well, **when are you going to pay me back?** ... I'm never going to loan it to you again. **You ain't got to worry about that with the [small-dollar loan].**"

Borrower quotes on small-dollar loan alternatives

While many borrowers had used alternative financial services in the past, they preferred the bank-offered small-dollar loans, finding them more affordable (see Table 2), less stressful, and easier to access. As a result, those interviewed felt they would be less likely to use payday loans, or similar products, in the future. Additionally, small-dollar loans were a welcome alternative to borrowing from friends and family, which frequently resulted in fraught conversations around repayment complicating their personal lives.

TABLE 2: COST TO BORROW BANK-ISSUED SMALL-DOLLAR LOAN VS. TYPICAL PAYDAY LENDER

Bank	Product	Cost to borrow $500 for loan's term	Savings to borrow $500 for stated term vs. typical payday lender
usbank	**Simple Loan**	$30	$420
BANK OF AMERICA	**Balance Assist**	$5	$445
Huntington Bank	**Standby Cash**	$25	$425
REGIONS	**Protection Line of Credit**	$10	$440
TRUIST	**Cash Reserve**	$19	$581
WELLS FARGO	**Flex Loan**	$20	$580

Source: The Pew Charitable Trusts
**ideas42 included Huntington Bank's recently announced pricing change in Table 2.*

Finally, small-dollar loans provide peace of mind for many borrowers. Customers reported feeling more secure knowing that, should a challenge arise, they could rely on their primary banking partner as a reliable, affordable credit option.

"It was easy … they can deposit the money within minutes … [with] no hidden fees … I don't have to look around and see who's going to let me borrow some money when my **bank is already offering that service.** And I already bank with the bank for over seven years, so I already have some type of trust with them."

"It helps … if I did ever really need it again, I can use it and I don't have to worry about anything like that. So that does **remove some stress.**"

"**I recommended my best friend …** I told her how easy it was and I was excited when I actually got approved. I thought I was never going to get approved for something like that."

Borrower quotes on small-dollar loan experience

Opportunities to improve the borrower experience

While the overall customer experience with small-dollar loans was positive, there is room for improvement around the communication of approval criteria, loan sizes, and credit concerns.

Borrowers were sometimes unsure about the factors determining approvals and particularly approval amounts. When they were approved for less than expected, the process could feel especially ambiguous. Greater clarity and transparency around approvals could further increase trust and satisfaction in the product as borrowers would receive what they anticipated.

Borrowers who can demonstrate the ability to reliably repay would also like a better understanding of how they could become eligible for larger loans and other credit products. While they generally appreciated loan sizes as mentioned previously, the maximum bank-offered small-dollar loan is $1,000 which is less than some borrowers' needs. Despite most banks *not* using credit scores in the approval process, some borrowers were also unsure if or how their credit scores impacted their application. In general, borrowers expressed indifferent or strongly negative opinions on whether banks should use credit scores for approvals, and repeat borrowers were aware that hard credit pulls could affect their credit score, diminishing their interest in small-dollar loans.

Borrowers were also unsure if their banks were reporting repayment history to the credit bureaus; those who were more concerned about their ability to repay on time were worried about the negative impact, and others were unsure if on-time repayment of small-dollar loans positively affected their credit scores.

“The **main negative for [the bank] is that it does a credit check** … if life should hit you a couple of times back-to-back, that could become an issue on your credit that you got a couple of dings back quickly depending on the time between those two.”

“I was like, man, what if I apply and I get denied, and **is it going to affect my credit score?**”

Borrower quotes on credit scores and credit reporting

Looking ahead

The growth in the number of small-dollar loan providers has been a major positive development and provided millions of Americans with a reliable bridge to weather financial disruption. Millions more families could benefit from access to small-dollar loans delivered by the mainstream institutions where they already hold their savings and deposit their paychecks.

Banks have the opportunity to leverage this demand for small-dollar loans to reach a large market of viable customers, serve their communities, and do so sustainably. In an environment of minimal regulatory uncertainty and with innovations in underwriting and product delivery, early movers in the small-dollar loan space have demonstrated that they can achieve genuine scale and save their customers millions of dollars. For the institutions that don't offer a small-dollar loan, there are strong business and mission-based reasons to launch these sustainable, consumer-friendly products.

"You know what? **I was just thankful because they were there when I needed.** So I was happy that they provided these new loans because they're small and it's easier for me to pay them back."

Borrower quote: father of two who used loans for child's sporting event and house repairs

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