2018 Alternative Financial Services Lending Trends
Insights into the Industry and Its Consumers
How subprime borrower behavior impacts the alternative finance market

Understanding consumer trends and preferences is key to providing the financial services consumers need.

For many subprime consumers, securing traditional credit is challenging or impossible. Alternative credit data can help align these consumers with the right credit products for their needs, while providing more precise risk assessment for lenders.

Clarity Services, a part of Experian, provides valuable alternative credit data to complement traditional credit reporting. The combination of traditional and alternative data gives lenders a more complete picture of subprime applicants so they can make better, more informed decisions.

Clarity analyzed the trends and financial behavior of subprime consumers by looking at application and loan data in its specialty credit bureau from 2013 through 2017. A study sample of nearly 20 million loans and 200 million applications was created and leveraged to evaluate market trends during this period. Data from Experian’s national credit bureau was also used to help profile consumers.
Alternative Financial Services

Millions of Americans lack the credit history to secure a loan in the prime credit market. Subprime consumers are often viewed as a single, uniform segment of the population even though the circumstances, behaviors and intentions behind their use of credit are vastly different. For each consumer, financial service providers must consider what led to their subprime credit status. Is the consumer:

• A young person without sufficient credit history to properly qualify for a traditional loan?
• An otherwise creditworthy consumer who encountered a destabilizing financial event like a job loss or unexpected medical issue?
• A recent immigrant with little to no credit history in the U.S.?
• Someone who has been irresponsible with credit?

The alternative financial services market is crucial to many of these consumers to help them manage monthly expenses through periods of financially destabilizing events, and income volatility. Alternative finance products include, but are not limited to, short-term loans (installment loans, subprime credit cards, auto title loans, rent-to-own) and single pay credit (pawn shops, payday loans) and others. This report references the following loan channels and loan types:

Loan Channels

Online – Online lenders who conduct business via the internet. The application process and funding is completed without the consumer being present.

Storefront – Storefront lenders are lenders with a physical brick and mortar location to serve consumers.

Loan Types

Installment – Installment loans are structured to be repaid over a period of time (months or years) in a series of payments.

Single Pay – Single pay loans are repaid in one lump sum payment, usually over a shorter time period (days or weeks).

Much of the analysis to follow will focus on online lending trends as this is a rapidly growing channel and of high interest to the market.
At-a-Glance

Market Trends
Online installment lending has continued its growth in both number and funded loan volume, while growth has slowed in both categories for the online single pay market. Not only have average installment loan amounts increased, but consumers are also opening more loans per year. The overall funded loan volume growth from 2013 to 2017 was nearly 500 percent.

Credit Utilization
Online installment borrowers have remained active in the market and have used more credit each year. From 2016 to 2017, the average credit utilization per borrower (average loan amount times average number of loans) increased from $1,861 to $2,163.

Credit Quality
When controlling for seasonal variation, cumulative default rates have declined year-over-year. Lenders have leveraged alternative credit data effectively to mitigate risk while significantly growing their loan portfolios.

Loyalty
Borrowers are rarely 100 percent loyal to a specific loan channel. For instance, a study of storefront single pay borrowers from 2013 and 2014 showed an increasing interest in online transactions in the years that followed. While consumers applied in both online and storefront channels prior to opening a storefront loan, a full one-third of these borrowers had inquiries in the online channel by 2017.

Consumer Stability & Demographics
Installment borrower (stated) incomes are significantly higher than single pay, and have been increasing over the past five years. Overall, borrowers leveraging online channels for loans tend to be younger than storefront borrowers. Surprisingly, Generation X is the largest user group in the online channel, leading the millennials by a full 7 percent.
Market Trends
Online Lending Volume and Product Mix

To get a true sense of the growth in the online loan market, funded loan volumes ($) and number of funded loans were measured over the five-year period (2013-2017). Both metrics for installment loans showed strong, consistent growth over five years, while single pay showed smaller growth followed by a dip in 2017. Figure 1A illustrates the most striking example of installment growth. Funded loan volumes grew almost 500 percent from 2013 to 2017 (2013 funded loan volume was indexed at 100). Similar trends were observed in Figures 2A and 2B, where the number of funded loans were calculated over the same five-year period.

Figure 1A: Growth of Funded Loan Volume ($) – Online Installment

Figure 1B: Growth of Funded Loan Volume ($) – Online Single Pay

Figure 2A: Growth in Number of Funded Loans – Online Installment

Figure 2B: Growth in Number of Funded Loans – Online Single Pay
Table 1 shows the percentage growth for online loans by looking at year-over-year changes in loan count, dollar value of funded loans and unique borrower count.

Online installment shows consistent growth, with a notable increase from 2014 to 2015, with all categories growing by more than 100 percent. Meanwhile, single pay grew each year until 2017.

### Table 1:
**Year-over-Year Growth of Online Loans**

<table>
<thead>
<tr>
<th></th>
<th>Funded Loan Volume</th>
<th>Number of Funded Loans</th>
<th>Number of Unique Borrowers</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Installment</td>
<td>Single Pay</td>
<td>Installment</td>
</tr>
<tr>
<td>2013 – 14</td>
<td>49%</td>
<td>3%</td>
<td>2%</td>
</tr>
<tr>
<td>2014 – 15</td>
<td>153%</td>
<td>19%</td>
<td>135%</td>
</tr>
<tr>
<td>2015 – 16</td>
<td>19%</td>
<td>68%</td>
<td>12%</td>
</tr>
<tr>
<td>2016 – 17</td>
<td>30%</td>
<td>-16%</td>
<td>12%</td>
</tr>
</tbody>
</table>

**Loan Growth Installment Lending**
While the number of loans increased by 12% and the number of borrowers by only 9%, the dollar value grew by 30%.

**Loan Growth Single Pay Lending**
In contrast to installment loans, there is a decrease in the number of single pay loans by more than a quarter. The dollar value decreased by 16% despite an increase in unique borrowers.
Credit Utilization
Observations + Trends

In addition to the upward trend of online installment loan amounts, the analysis shows that single pay borrowers take out more loans of lesser value than installment borrowers. This section focuses on average loan amounts by market.

The pink line shows the trends in the number of loans that borrowers are opening each year. For example, in 2017, the average online installment loan amount was $1,442 and the average number of loans was 1.5. When these numbers are multiplied, the result is the average credit utilization per borrower for 2017 ($2,163).

One possible reason for the increase in online installment loan amounts may be the use of direct mail marketing. Direct mail campaigns typically offer larger loan amounts to pre-qualified borrowers.

Average Loan Amount and Average Number of Loans per Borrower

Figure 3A: Online Installment Loans

Figure 3B: Storefront Installment Loans

Figure 3C: Online Single Pay Loans

Figure 3D: Storefront Single Pay Loans
Credit Quality
Loan Performance in the Market

Cumulative default curves were constructed by origination quarter to control for seasonality. Figure 4A shows cumulative default curves for first quarter funded loans from 2015 through 2017. Note that cumulative default rates declined year-over-year. For example, after six months of aging, cumulative default rates were 30 percent, 28 percent and 20 percent for 2015, 2016 and 2017 respectively.

Figures 3A-D Cumulative Default Curves Based on Date of Funding by Quarter for Online Installment Loans

Figure 4A:
First Quarter

Figure 4B:
Second Quarter

Figure 4C:
Third Quarter

Figure 4D:
Fourth Quarter

Defaults are declining year-over-year.
Loyalty

Fluidity: Cross-Channel Activity

In order to assess borrower fluidity across channels, we evaluated a group of consumers who opened storefront single pay loans between the years of 2013 and 2014 and monitored their activity over the next several years. These borrowers are on average 45 years old with a monthly income of $1,980. Even while they opened storefront loans, many were also applying for online credit. The number of online applications continued to increase in the years that followed.

Table 2 shows the percentage of single pay borrowers who applied online and the average number of applications they generated per year. In 2017 alone, more than 17 percent of the borrowers were seeking online credit, averaging 13 inquiries that year.

Table 2:

2013-2014 Storefront Single Pay Borrowers with Subsequent Online Inquiry

<table>
<thead>
<tr>
<th>Year(s)</th>
<th>% Single Pay Borrowers</th>
<th>Avg. # of Online Inquiries</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>18.1%</td>
<td>7</td>
</tr>
<tr>
<td>2015</td>
<td>15.1%</td>
<td>11</td>
</tr>
<tr>
<td>2016</td>
<td>16.1%</td>
<td>10</td>
</tr>
<tr>
<td>2017</td>
<td>17.3%</td>
<td>13</td>
</tr>
</tbody>
</table>

Figure 5 shows the distribution of online applications by product type for that same consumer sample. A greater percentage of storefront single pay borrowers applied for online installment versus online single pay loans over time. As consumers had more opportunities to conduct various types of business online over the years, it is possible that they became more comfortable using this channel for their borrowing as well.

Figure 5:

Types of Online Loans Sought by 2013-2014 Storefront Single Pay Borrowers

Average Borrower with a Storefront Single Pay Loan in 2013 or 2014

Age: 45
Monthly Income: $1,980

Shift to Online Lending
By 2017 more than a third of these borrowers sought online credit.
Consumer Stability

Changes in Consumer Identity Elements Over Time

In the subprime market, consumer stability is directly linked to future loan performance. Frequent changes to a consumer’s mobile phone number, bank account or home address is often associated with increased risk. For example, there is heightened risk when a consumer provides three or more bank accounts on loan applications in a year.

It is important to note that in the case of bank accounts, it is not just about the number of changes in bank accounts, but how recently the bank account became active. For 2017, consumer stability remained fairly consistent with little change to key attributes often associated with risk.

Table 3:
Number of Changes in Mobile Phone Number, Bank Account and Home Address

<table>
<thead>
<tr>
<th>Changes</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mobile Number</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>87%</td>
<td>91%</td>
<td>90%</td>
</tr>
<tr>
<td>1</td>
<td>10%</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>2+</td>
<td>3%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Bank Account</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>85%</td>
<td>89%</td>
<td>89%</td>
</tr>
<tr>
<td>1</td>
<td>11%</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>2+</td>
<td>4%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Home Address</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>0</td>
<td>88%</td>
<td>91%</td>
<td>90%</td>
</tr>
<tr>
<td>1</td>
<td>10%</td>
<td>7%</td>
<td>9%</td>
</tr>
<tr>
<td>2+</td>
<td>2%</td>
<td>1%</td>
<td>2%</td>
</tr>
</tbody>
</table>

Studies have shown that a consumer who provides 3 or more bank accounts on loan applications in a year is 28% more likely to default.
Consumer Demographics

Age and Income

For this section the analysis looks at basic demographics including distributions of age and stated income of borrowers across various markets. Table 4 shows the differences in the average ages of the online and storefront borrower. Consistently, the online borrowers are younger than storefront borrowers.

Table 4:
Age of Borrower by Market for All Loans 2013-2017

<table>
<thead>
<tr>
<th>Generation</th>
<th>Online Installment</th>
<th>Online Single Pay</th>
<th>Storefront Installment</th>
<th>Storefront Single Pay</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average</td>
<td>45</td>
<td>41</td>
<td>47</td>
<td>48</td>
</tr>
<tr>
<td>Median</td>
<td>44</td>
<td>39</td>
<td>47</td>
<td>48</td>
</tr>
<tr>
<td>75%</td>
<td>53</td>
<td>49</td>
<td>58</td>
<td>59</td>
</tr>
<tr>
<td>25%</td>
<td>35</td>
<td>30</td>
<td>36</td>
<td>36</td>
</tr>
</tbody>
</table>

The age data in Figure 6 confirms conventional wisdom – that the online channel tends to be younger than the storefront market. The additional data provided by Experian shows that consumers in the national credit bureau are considerably older than the consumers seen in the alternative finance channels (represented in Clarity’s specialty bureau).

Figure 6:
Distribution of Generations by Channel vs a National Credit Bureau

Table 5 displays the percentage of borrowers and the percentage of storefront loans for the subprime market, broken down by generation. Millennials represent 25 percent of the subprime loan market, but they open 34 percent of the loans.

Table 5:
Subprime Borrower and Storefront Loan Distributions by Generation

<table>
<thead>
<tr>
<th>Generation</th>
<th>Percentage of Loans</th>
<th>Percentage of Borrowers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gen Z</td>
<td>1%</td>
<td>2%</td>
</tr>
<tr>
<td>Millennials</td>
<td>34%</td>
<td>25%</td>
</tr>
<tr>
<td>Gen X</td>
<td>36%</td>
<td>32%</td>
</tr>
<tr>
<td>Boomer</td>
<td>26%</td>
<td>34%</td>
</tr>
<tr>
<td>Silent</td>
<td>3%</td>
<td>7%</td>
</tr>
</tbody>
</table>
Borrower income is an important factor in evaluating a consumer. Table 6 shows the average and median annual incomes for all borrowers from 2013 through 2017. Storefront single pay incomes are notably lower than online single pay, yet installment borrower incomes are nearly equal for storefront and online channels.

Table 6:  
Average and Median Income by Market Loan Type

<table>
<thead>
<tr>
<th>Market Loan Type</th>
<th>Average</th>
<th>Median</th>
</tr>
</thead>
<tbody>
<tr>
<td>Online Installment</td>
<td>$37,929</td>
<td>$30,000</td>
</tr>
<tr>
<td>Storefront Installment</td>
<td>$36,696</td>
<td>$29,616</td>
</tr>
<tr>
<td>Online Single Pay</td>
<td>$33,549</td>
<td>$27,000</td>
</tr>
<tr>
<td>Storefront Single Pay</td>
<td>$23,334</td>
<td>$19,752</td>
</tr>
</tbody>
</table>

Incomes for installment loans are generally increasing, with online tracking slightly higher than storefront. Over the five year period, reported incomes rose 16 percent for online installment and 12 percent for storefront.

The upward trend in Figure 7 does not necessarily mean that borrowers are seeing an increase in their income; only that those who secure an online installment loan have a higher income. Product trends show that lenders are funding larger loans for longer periods of time, warranting a more conservative underwriting criteria.

Figure 7:  
Average Annual Income Trends by Channel – Installment Loans

- Storefront single pay lenders may have less requirements because the consumer is physically present during the transaction.
Figure 8 compares the distribution of borrower incomes for online installment and online single pay borrowers in 2017, reinforcing that incomes for those that obtained installment products tend to be higher than for single pay products.

- Thirty-five percent of the online installment borrowers report an annual income over $40,000, while only 25 percent of single pay borrowers reported incomes are in this range.

- Conversely, 30 percent of single pay borrowers have an income less than $20,000, as opposed to only 20 percent of installment borrowers’.

Looking at these income distributions, it is clear that the online installment borrowers have a higher average income than the online single pay. A single pay lender must only recover one payment. The installment lender must take into consideration a series of repayments from the borrower over a longer time period. The lender is exposed to more risk due to possible income volatility of the borrower during the term of his loan.

Figure 8: Online Borrower Income Distribution by Product 2017
Location
Where Are Borrowers Located?

Table 7 shows the top 10 states ranked by online loan count for 2017. State rankings are provided for years leading up to 2017. California and Texas have remained the most significant markets for online lenders, due in part to their large population size.

Some of the growth trends in the table are interesting. States like Ohio and Florida experienced slow but consistent growth over the past few years, whereas other states like Michigan and Oklahoma experienced a sharper growth.

Table 7:
Top 10 Online Loan States by Loan Count 2013-2017

<table>
<thead>
<tr>
<th>State</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>CA</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>TX</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>OH</td>
<td>3</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>FL</td>
<td>9</td>
<td>7</td>
<td>5</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>AL</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>LA</td>
<td>19</td>
<td>12</td>
<td>7</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>MI</td>
<td>16</td>
<td>11</td>
<td>12</td>
<td>13</td>
<td>7</td>
</tr>
<tr>
<td>MO</td>
<td>15</td>
<td>8</td>
<td>10</td>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>OK</td>
<td>20</td>
<td>10</td>
<td>11</td>
<td>11</td>
<td>9</td>
</tr>
<tr>
<td>IL</td>
<td>14</td>
<td>9</td>
<td>9</td>
<td>8</td>
<td>10</td>
</tr>
</tbody>
</table>

Loan location is determined by the borrower’s address, not the lender’s location.
Figure 9 shows the percentage change in volume of borrowers from 2013 to 2017 by state. For instance, the number of people who opened a loan with an alternative finance lender in Illinois grew by 244 percent from 2013 to 2017.

The Midwest region showed notable growth, with four of the top 10 states located here (more than any other region in the country).

Figure 9:
Growth of Unique Consumers from 2013-2017
A Growing, Healthy Marketplace

Following is a summary of key insights resulting from the analysis conducted using a robust sample from Clarity’s alternative credit loan data.

- The online small-dollar installment loan market continues to significantly grow (with a recent surge in the Midwest region).
- Credit quality for online small-dollar installment loans continues to improve year-over-year.
- Storefront single pay loan customers are becoming more comfortable with applying for online loans, with a growing percentage seeking installment loans.
- Online installment borrowers have higher stated incomes than online single pay borrowers.
- There were no significant changes in commonly used measures of consumer stability over the last year.

We welcome questions or discussions on this report.
About Clarity

Clarity Services, Inc., a part of Experian, is the leading credit reporting agency for near-prime and subprime consumers. Clarity's growing specialty credit data encompasses more than 62 million unique consumer identities that helps businesses mitigate risk using alternative credit data.