

2019

Alternative Financial Services Lending Trends

Insights into the Industry and its Consumers



How nonprime borrower behavior impacts the alternative finance market

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

For many nonprime 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 alternative financial service providers. Clarity's alternative data gives lenders a more complete picture of nonprime applicants, so they can make better and more informed decisions.

We analyzed the trends and financial behavior of nonprime consumers by looking at application and loan data in Clarity's specialty credit bureau from 2014 through 2018. A study sample of more than 350 million consumer loan applications and more than 25 million loans 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 traditional credit market. Nonprime 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 nonprime credit status. The consumer could be:

- 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.
- Someone who needs cash quickly and doesn't have time to wait to be approved for traditional credit products.

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, nonprime credit cards, auto title loans, rent-to-own), single pay credit (pawn shops, payday loans) and others. This report references the following loan channels and loan types:

Loan Origination Channels

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

Storefront – Lenders with a physical brick and mortar location to serve consumers. The loan application is processed with the consumer present.

Loan Types

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

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



At-a-Glance



Market Trends

Online installment lending has continued its significant growth in both number and funded loan volume, while growth has flattened out in the online single pay market.

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Changes in Loan Characteristics

Recent trends in online installment loan characteristics include larger loan amounts (higher percentage of \$1000+), longer repayment terms (higher percentage 7+ months) and smaller scheduled payments. There has also been a slight decline in average loans per consumer.

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Credit Quality

Based on a comparison of year-over-year cumulative default curves for quarterly online installment loan cohorts (controlling for seasonal variations), there are early signs of deterioration in loan performance, especially second and third quarter loan originations for 2018.

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Loyalty

In today's competitive market, there are more options for borrowers in both alternative financial services (AFS) and traditional lending. In 2018, just over half of the consumers who obtained an online loan were new to the AFS market. Conversely, 7% of consumers who had an AFS loan in 2017 were not seen in the AFS market in 2018 but were observed with a new loan from a traditional lender.

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Consumer Demographics

Consumers new to alternative financial services in 2018 have slightly higher credit scores than those who previously applied for loans in this market. In addition, millennials have a larger presence in AFS online lending than either AFS storefront or traditional lending in 2018. Over the past five years, there has been a trend toward higher reported net monthly incomes in the online channel.

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Market Trends

Online Lending Volume and Product Mix

To characterize the growth of the online loan market between 2014 and 2018, we measured online installment and single pay loans by the number of loans originated and total dollars funded.

Figure 1A illustrates continued growth in online installment loans with total dollars funded being 7.4 times higher in 2018 than in 2014 (2014 funded loan volume was indexed at 100). **Figure 1B** shows funded loan dollars for online single pay loans to peak in 2016 and flatten out between 2017 and 2018. Similar trends were observed in **Figures 2A and 2B** where the number of funded loans was calculated over the same five-year period for online installment and online single pay.

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

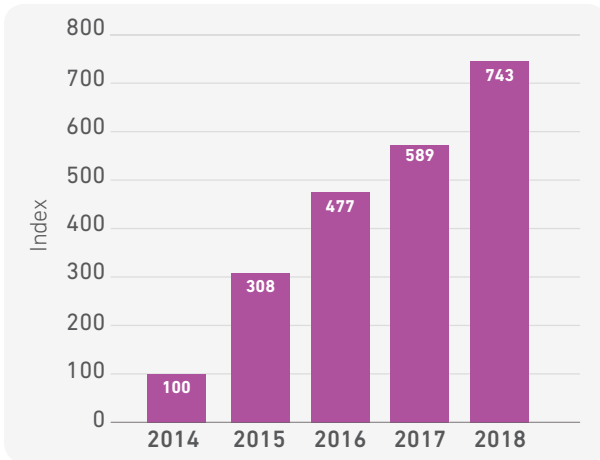


Figure 1B:
Growth of Funded Loan Volume (\$) –
Online Single Pay

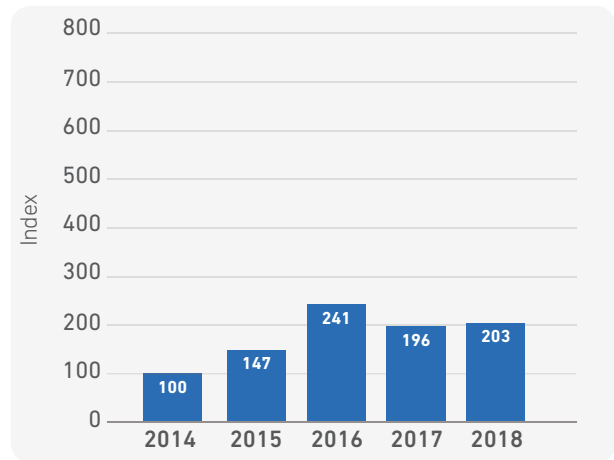


Figure 2A:
Growth in Number of Funded Loans –
Online Installment

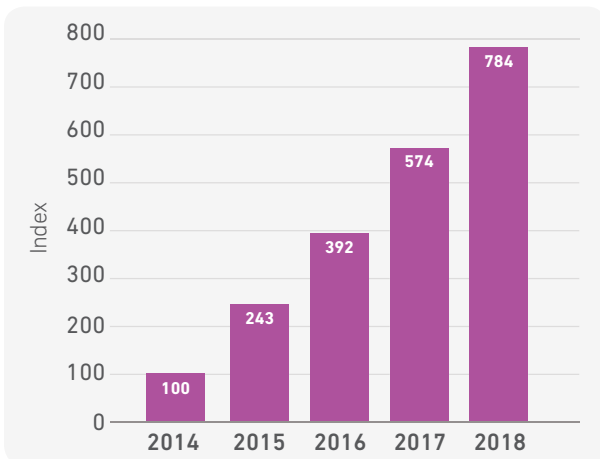
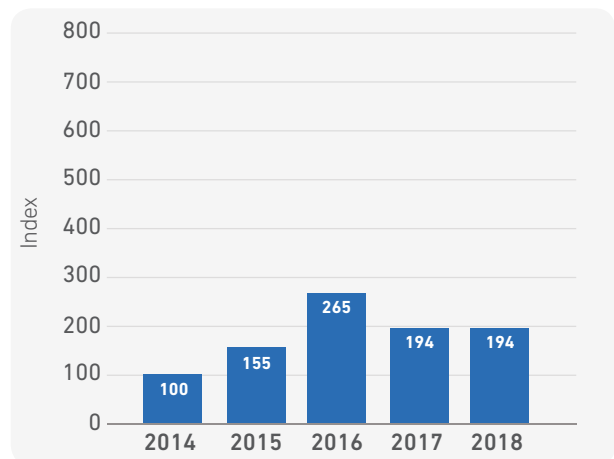


Figure 2B:
Growth in Number of Funded Loans –
Online Single Pay



Year-Over-Year Growth of Online Loans

Funded online installment loans are growing much faster than online single pay loans. Over the last two years, online installment loans continued to grow at a robust clip, while online single pay loans trended toward negative or flat growth. The number of unique borrowers for installment loans has increased by approximately 30% yearly for the past three years, while unique borrowers declined for online single pay loans over the last two years. Based on the data, it appears that single pay borrowers are more likely to exit the online market or migrate to online installment loans.

Table 1 illustrates the percentage of growth for online loans by looking at the year-over-year changes in funded loan dollars, number of funded loans and number of unique borrowers.

Table 1:
Year-to-Year Percentage Change in Online Loans and Borrowers

	Funded Loan Volume		Number of Funded Loans		Number of Unique Borrowers	
	Installment	Single Pay	Installment	Single Pay	Installment	Single Pay
2014-2015	208%	47%	143%	55%	124%	42%
2015-2016	55%	64%	61%	71%	32%	25%
2016-2017	23%	-18%	46%	-27%	30%	-12%
2017-2018	26%	3%	37%	0%	32%	-5%



Loan Growth Installment Lending

Number of unique borrowers grew by **30%** yearly in the past three years.

Changes in Loan Characteristics

Observations + Trends

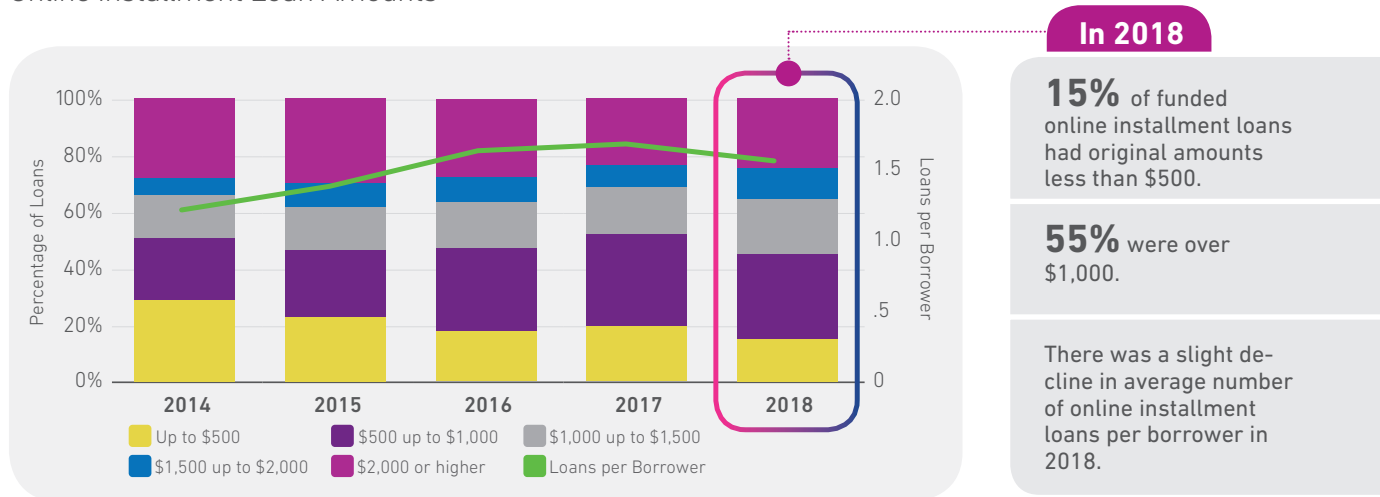
Installment Loans

The distributions of loan amounts, repayment terms and scheduled payment amounts for installment loans were formulated to show how they have changed over the last five years.

Loan Amount

Figure 3 shows the distribution of loan amounts over time. Each bar represents installment loans for that particular year, with each segment of the bar identifying the percentage of loans that fall into the specific range of loan volumes. These percentages can be determined from the left vertical axis. The line tracks the average number of installment loans per borrower for each year. The scale for average number of funded online installment loans is shown on the right vertical axis.

Figure 3:
Online Installment Loan Amounts



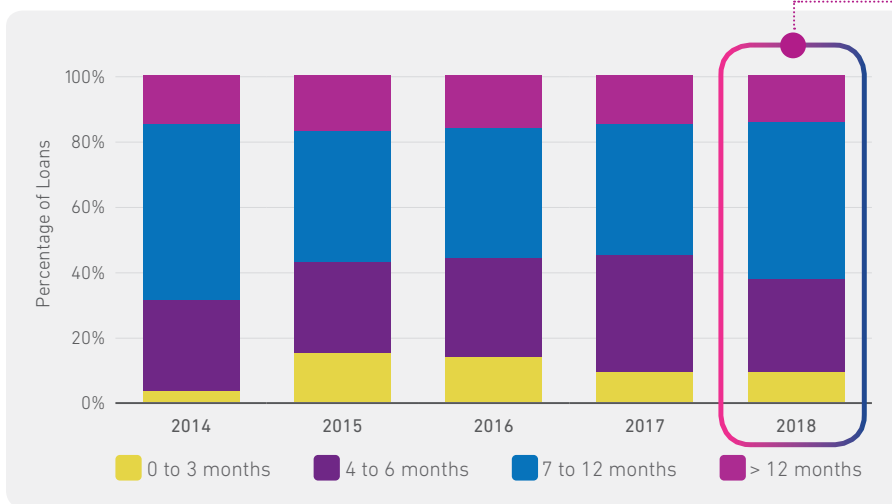
Observations and Trends

There has been a trend toward higher loan amounts over the last five years. For example, the percentage of funded loan amounts between \$500 and \$2,000 represented 43% of all loans in 2014 and increased to 60% in 2018. Loan amounts up to \$500 accounted for 29% of the market in 2014, but in 2018, they made up less than 15% of the market. The average number of installment loans per borrower has slightly declined in 2018.

Length of Repayment

Figure 4 shows the distribution of loan repayment terms over time. Each bar represents installment loans for that particular year, and each segment of the bar identifies the percentage of loans that fall into the specific range of repayment length. These percentages can be determined from the left vertical axis.

Figure 4:
Repayment Length Distribution



In 2018

9% of funded online installment loans were scheduled to be repaid over <3 months.

62% had a repayment length over 7 months.

Observations and Trends

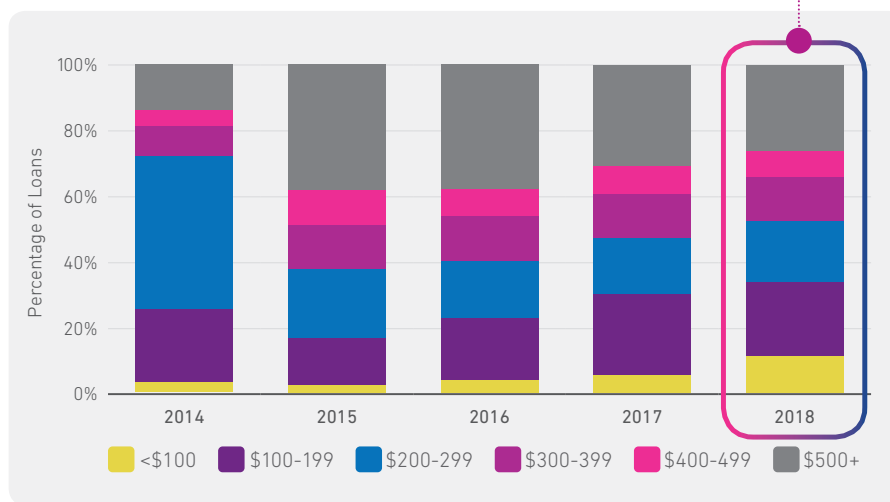
Fewer loans with payment terms less than three months were seen in 2018 than in 2015, while a greater percentage of loans are being repaid over 7 to 12 months in 2018.



Scheduled Monthly Payment Amount

Figure 5 shows the distribution of scheduled monthly payment amounts over time. Each bar represents installment loans for that particular year, and each segment of the bar identifies the percentage of loans that fall into the specific range of payment amounts. These percentages can be determined from the left vertical axis. Since many online installment loans have bi-weekly repayment frequency, all have been converted to monthly equivalent for comparative purposes.

Figure 5:
Scheduled Payment Amount



In 2018

12% of funded online installment loans had a scheduled payment amount of <\$100.

26% had a scheduled payment amount of \$500 or more.

There was a significant decline in percentage of monthly scheduled payment amounts exceeding \$500.

Observations and Trends

Payment amounts for installment loans have been decreasing since 2015. For example, 17% of online installment loans in 2015 had a monthly scheduled payment less than \$200. In 2018, the percentage of loans in this category grew to 34%. This aligns with longer payment terms now being offered.

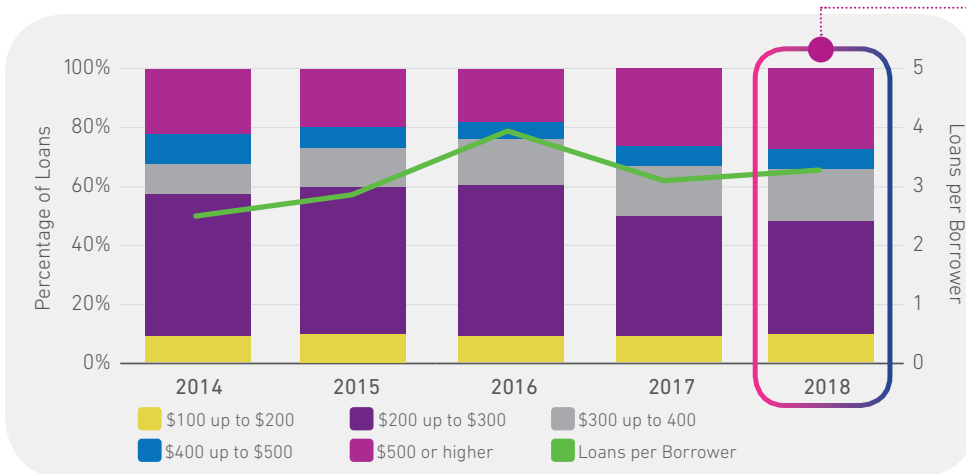
Single Pay Loans

This section explores how the single pay loan has changed over the last five years.

Utilization

Figure 6 shows the distribution of loan amounts over time. Each bar represents single pay loans for that particular year, and each segment of the bar identifies the percentage of loans that fall into the specific range of loan amounts. These percentages can be determined from the left vertical axis. The line is tracking the average number of installment loans per borrower for each year. Values are on the right vertical axis.

Figure 6:
Single Pay Loan Utilization



In 2018

9% of funded online single pay loans had amounts between \$100 and \$200.

28% were \$500 and higher.

The average number of loans per borrower in 2018 was 3.2.

Observations and Trends

Loan amounts of \$200-\$300 used to make up over half of all online single pay loans, but only accounted for 38% of them in 2018. In contrast, loans with amounts between \$300 and \$400 increased in percentage of the market from 10% in 2014 to 18% in 2018. Meanwhile, loans with amounts of \$500 or higher also grew from 23% in 2014 to 28% in 2018.



Credit Quality

Loan Performance in the Market

Online Installment Loan Performance

Cumulative loan default curves for online installment loans were constructed by origination quarter to control for seasonality.

Figures 7A-D show cumulative default curves for funded loans in each quarter from 2015 through 2018. Apart from 2015, default rates averaged between 35% to 40% for each quarter of each year, with most defaults occurring between six-and nine-months following origination. This information is based on Clarity's view of the industry for loan originations and their corresponding performance.

Figures 7A-D Cumulative Default Curves Based on Date of Funding by Quarter for Online Installment Loans

Figure 7A:
First Quarter

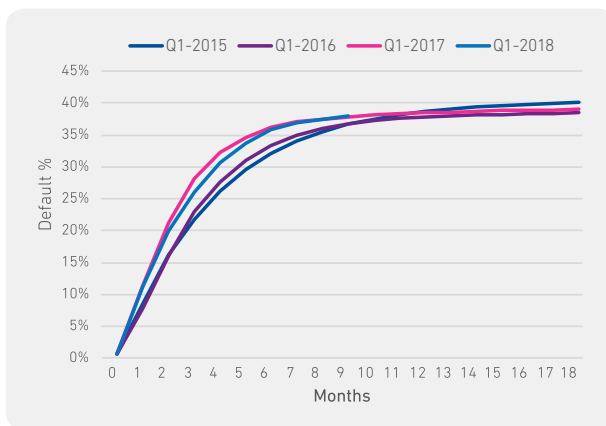


Figure 7B:
Second Quarter

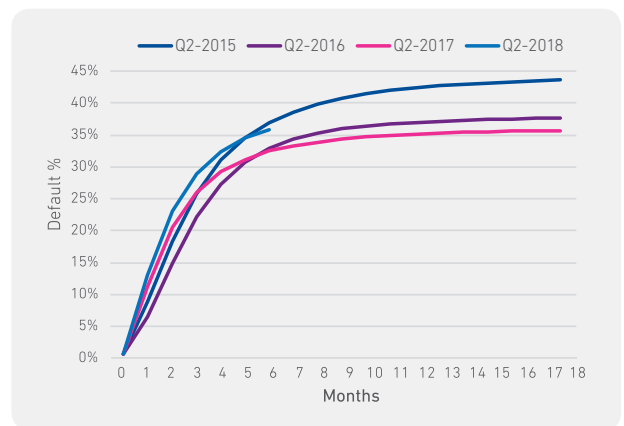


Figure 7C:
Third Quarter

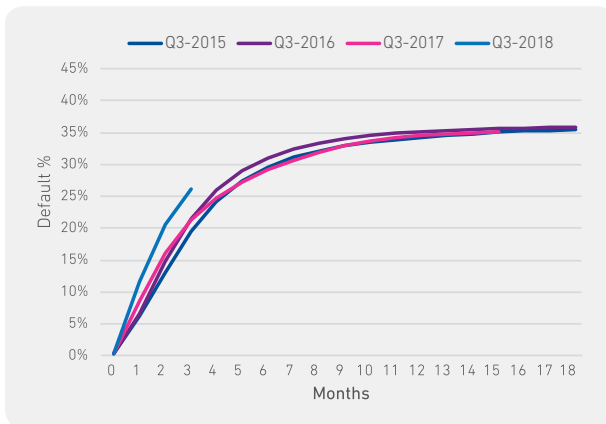
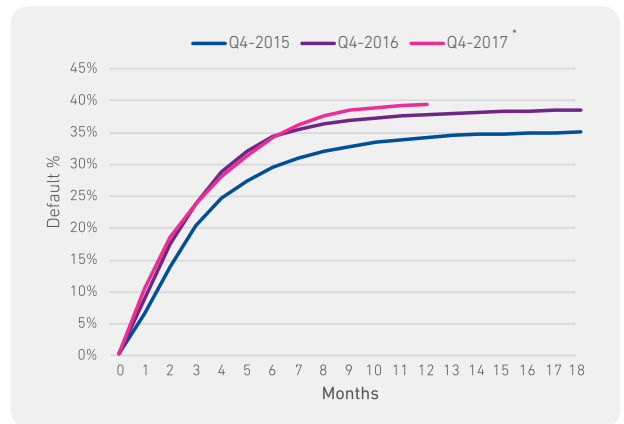


Figure 7D:
Fourth Quarter



*4th Quarter Cohort not shown due to insufficient seasoning

In 2018, second and third quarter originations show early signs of loan performance deterioration.

Online Single Pay Loan Performance

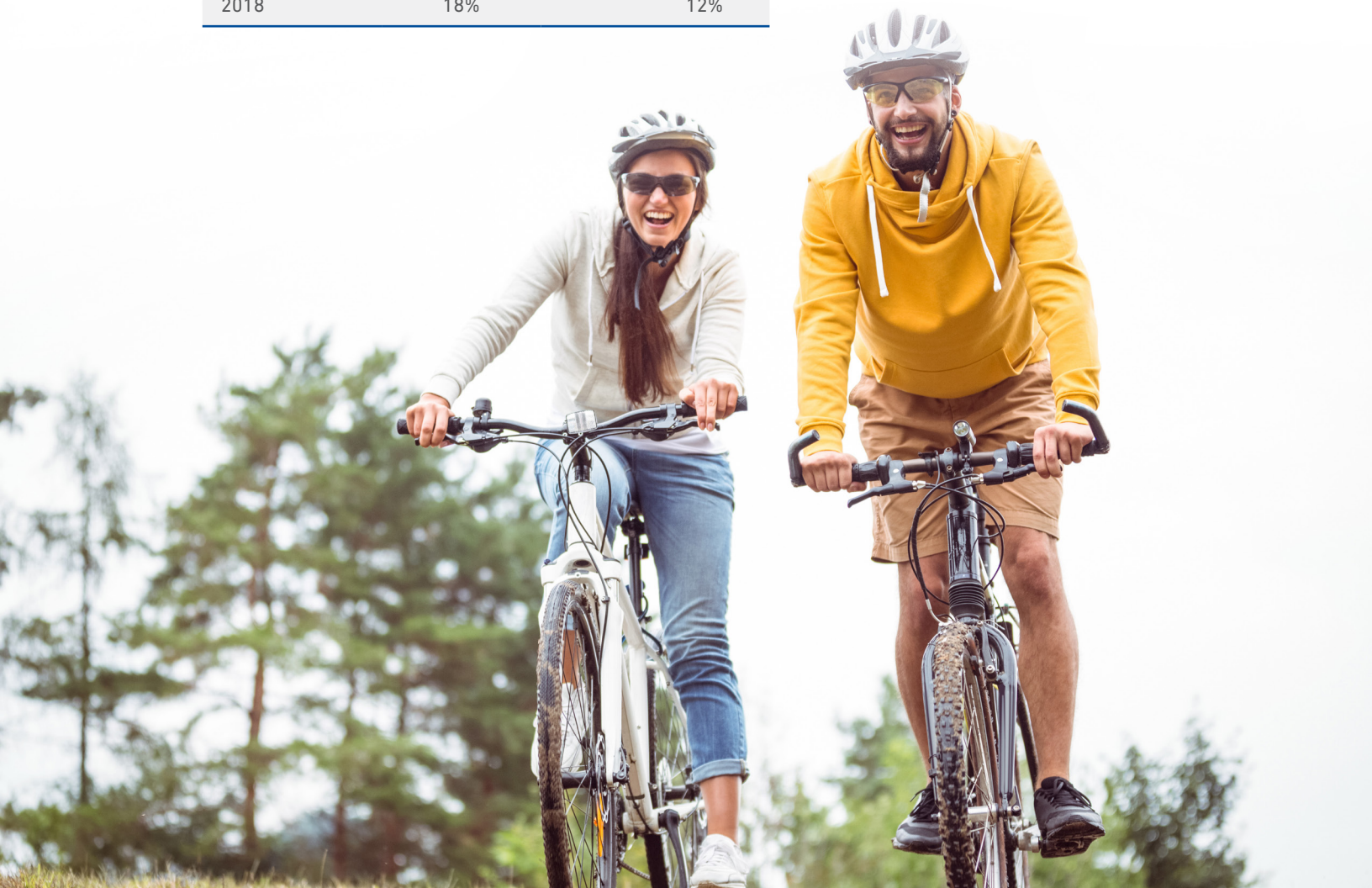
First payment default is a commonly used metric for evaluating single pay loan performance. Over the last four years, we found a downward trend in first payment default rates on the first online single pay loan the consumer originated in a year. In 2015, default rates for a borrower's first single pay loan was 24%, but in 2018, only 18% of these types of loans defaulted. Overall, first payment default rates for the first online single pay loan continued to decline in 2018.

Table 2 illustrates the first payment default rate for the first online single pay loan a consumer took out each year compared to the rate for subsequent loans. Subsequent loans are not necessarily from the same lender as the first loan.

Table 2:
Online Single Pay Loan Performance

Year	First Loan	Subsequent Loans
2014	20%	12%
2015	24%	11%
2016	24%	12%
2017	21%	13%
2018	18%	12%

First payment default rates for the first online single pay loan continued to decline in 2018.



Applicant Credit Profiles

We evaluated whether consumers with alternative finance loan application inquiries have seen shifts in their credit classification based on their VantageScore® 3.0 from 2015 to 2018. About 29% of consumers with an alternative credit inquiry fell into the prime or near prime categories in 2018 compared to about 21% in 2017.

Table 3 shows the percentage of consumers with inquiries that fall into each credit categorization, based on their VantageScore 3.0 from 2015 to 2018.

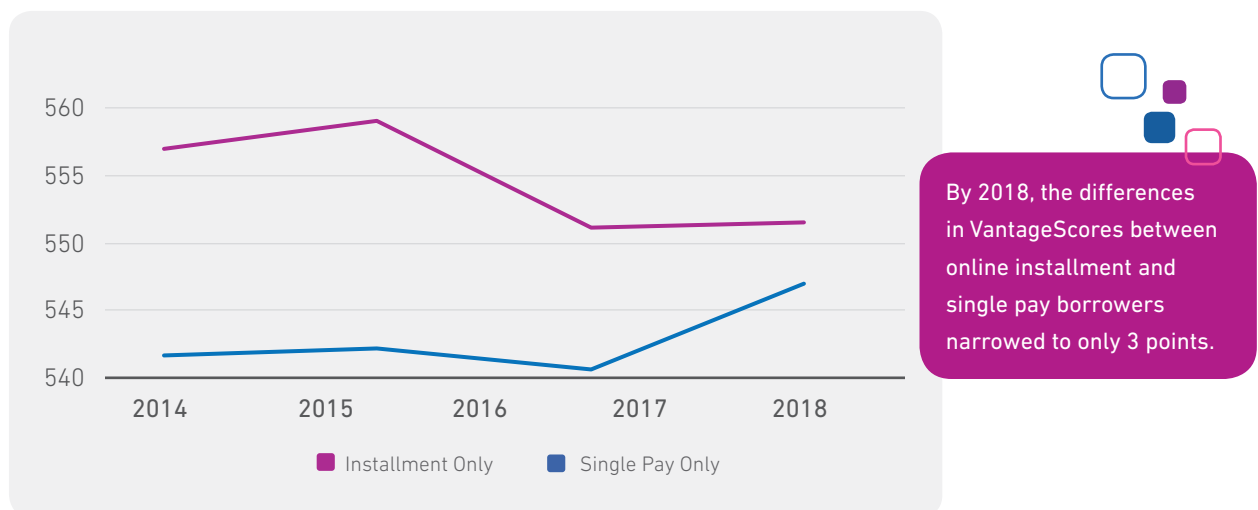
Table 3:
Credit Classification Percentage of Consumers with Inquiries by Year

	VantageScore 3.0 Categorization				
	No Score	Deep Subprime	Subprime	Near prime	Prime
2015	1.1	23.0	53.6	15.4	7.0
2016	1.3	22.4	55.1	15.2	6.1
2017	1.5	22.4	55.0	14.9	6.2
2018	1.4	17.0	52.6	19.0	10.0

On average, consumers with only installment loans had an average score almost 13 points higher than consumers with only single pay loans in 2015. This gap narrows each year in our findings with installment and single pay loan borrowers trending toward the same credit value over time.

Figure 8 illustrates the average VantageScore 3.0 of consumers who used installment or single pay loans from 2015 to 2018, and how the scores are changing over time.

Figure 8:
Average VantageScore 3.0 for Consumers with Alternative Credit



Loyalty

Fluidity: Cross-Channel Activity

Consumers in the Online Market

We evaluated the past borrowing behavior of consumers in the online market in 2018 and found that more than half of all online borrowers are new to the alternative credit space. **Table 4** examines consumers who opened an online loan in 2018, tracking their past behavior from 2014-2018.

Table 4:

Prior AFS Presence for 2018 Online Borrowers

Borrower Type	Pattern	Percent
First Seen Online in 2018		50.5%
Continuous Online Presence	Since 2017	14.7%
	Since 2016	7.9%
	Since 2015	5.0%
	Since 2014	2.8%
Other AFS Presence		18.6%

2017 Borrower Behavior in 2018

We also tracked where 2017 alternative finance borrowers ended up in 2018. **Table 5** shows the 2018 borrowing behavior of consumers who took out a loan in 2017. We found that 41% of online borrowers took out an alternative loan again, while 24% neither opened a loan nor applied for one in 2018. In addition, 35% of these borrowers did apply for a loan but did not open one.

Table 5:

2018 Behavior of 2017 Borrowers

2018 Behavior of 2017 Borrowers	Percentage
Opened loans	41.3%
Applied for loans but did not open one	35.1%
Did not open any loans or have inquiries	23.6%



Where are the borrowers who opened an AFS loan in 2017 and did not apply for or open an AFS loan in 2018?

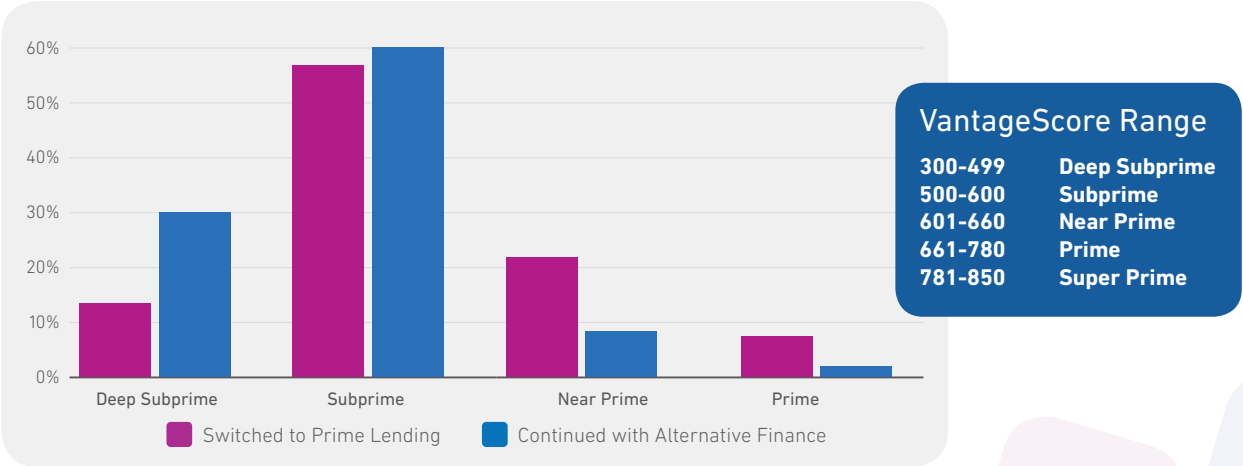
To answer this, we looked at the national credit database to see if these borrowers were active in traditional lending. We found that **34%** of these 2017 borrowers who had no applications or loans in 2018 had opened loans with traditional lenders. **Meaning 7% of 2017 borrowers overall switched to traditional lending in 2018.**

Credit Classification of Borrowers

How do the consumers who switched to traditional lending compare to those who continued in alternative financial services? Using VantageScore 3.0, we examined the credit classification of consumers who did and did not obtain loans from traditional lenders in 2018. We found about 23% of consumers who switched to traditional lending had a near prime credit score, while only 8% of those who continued in the alternative finance space were classified as near prime.

Figure 9 provides the credit classification of borrowers in 2018, comparing the percentage of borrowers who switched to traditional lending with borrowers who continued using alternative finance products.

Figure 9:
Credit Classification for Consumers who Switched to Traditional Lending in 2018 Compared to Consumers who Continued with Alternative Finance



Fraud Insights

Fraud has continued to evolve over the last five years, growing more sophisticated each year. Data breaches supply an inexhaustible supply of personal information to facilitate fraud. An ongoing fraud trend is the use of synthetic identities. Fraudsters use information from different consumers to produce identities that are difficult to detect as fraud. After the synthetic identities are established as an authorized user on a good account, it goes on to be used to commit fraud by opening additional accounts and making fraudulent transactions.

The Cost of Synthetic Identity Fraud

Due to synthetic identity fraud being difficult for lenders to detect, losses often result in charge-offs and fraud losses that are lumped in with other delinquencies, making the cost difficult to measure. Despite the difficulty in determining the cost of synthetic identity fraud, the Aite Group estimates that it has caused more than \$800 million in losses to US credit card issuers.*

Overcoming Synthetic Identity Fraud

Due to the visibility they have across multiple lenders, credit bureaus are well-equipped to detect this type of fraud early. They evaluate the following:

- If a Social Security Number has been used in multiple states or if there is an indication it belongs to another identity.
- If identity elements on an application are linked to other fraudulent accounts.

A newer tool used in fraud detection is to capture device data. Device-level indicators of fraud include:

- Non-fixed VOIP phone number
- Proxy IP address

Ultimately, analytic scoring models trained on known cases of synthetic identities can be applied to future applications. It's imperative that scoring models be tuned regularly to keep up with evolving fraud attacks.

*Data from *Synthetic identities: getting real with customers white paper* from Experian.



Consumer Demographics

Age and Income

For this section, we looked at basic demographics such as age and stated income of borrowers across various markets.

Borrower Age

Our findings indicate that online installment borrowers tend to be older than borrowers of online single pay loans. Conversely, installment borrowers were found to be about the same age as single pay borrowers in the storefront space.

Table 6 shows the difference in the average ages of the 2018 online and storefront borrowers.

Table 6:

Age of 2018 Borrowers

	Online Installment	Online Single Pay	Storefront Installment	Storefront Single Pay
Average	44	41	46	46
25%	35	31	34	33
Median	44	39	45	45
75%	53	50	57	57

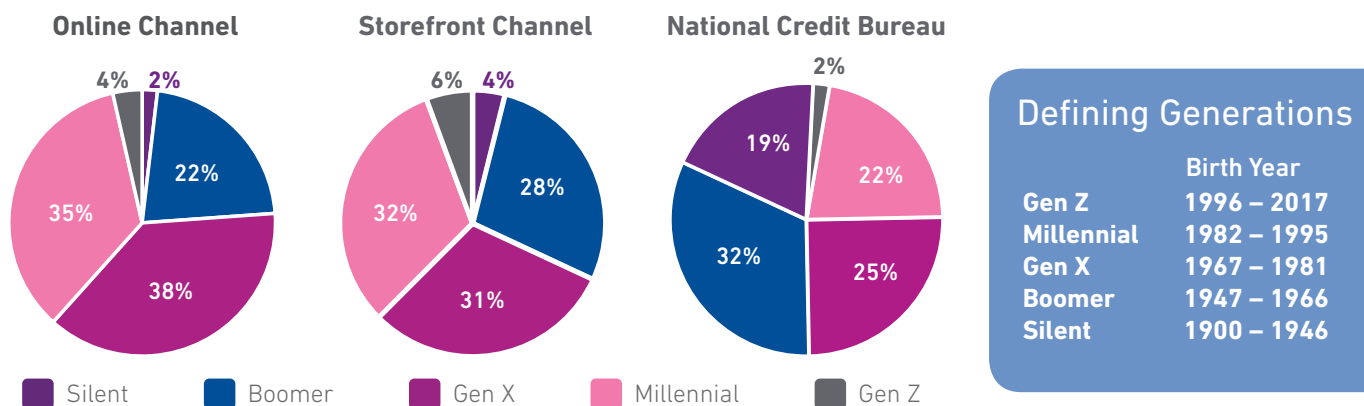
Generational Differences in Borrowing

There are significant generational differences in borrowing. Online alternative financial services borrowers are more likely to be part of Gen X than storefront borrowers. Another notable finding was that the Silent and Boomer generations account for more than half of all borrowers at a national credit bureau, but in the alternative financial services market, they only account for 25% to 30% of all borrowers.

Figure 10 illustrates the distribution of borrowers by generation in the online and storefront alternative financial services space, as well as a national credit bureau. The online and storefront data is represented by Clarity's specialty bureau, and the national credit bureau data is provided by Experian.

Figure 10:

Distribution of Generations by Channel vs a National Credit Bureau



Income Trends

Over the last five years, we found that consumer reported incomes trended higher in the online installment channel than in the storefront installment channel. Although online installment borrowers reported higher incomes, the values have remained steady since 2016. The reported incomes of storefront installment borrowers have been flat since 2014.

Figure 11 illustrates the median annual reported income for consumers who obtained an installment loan using an online or storefront channel during the five years from 2014 through 2018. The difference in reported income between online and storefront borrowers may reflect different applicant screening in these two channels.

Figure 11:

Average Annual Income Trends by Channel – Installment Loans

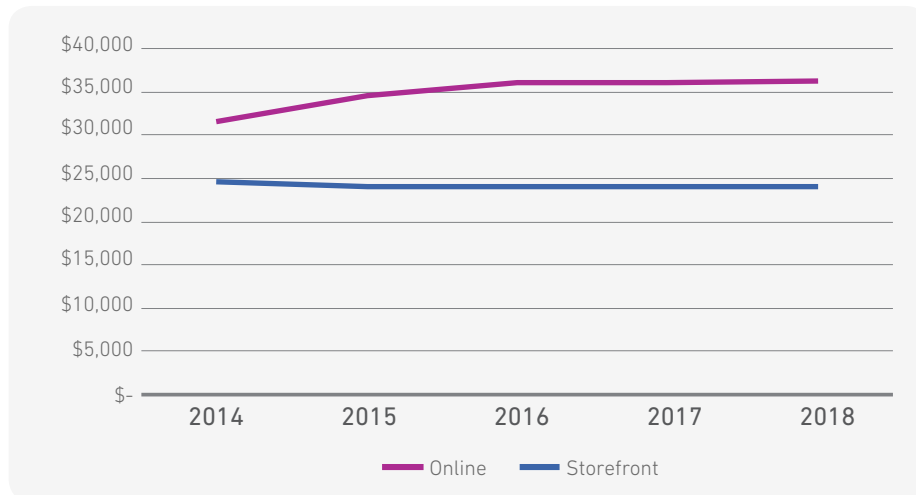


Figure 12 compares the distribution of reported borrower incomes for online installment and online single pay borrowers in 2018, reinforcing that incomes for those that obtained installment products tend to be higher than for single pay products.

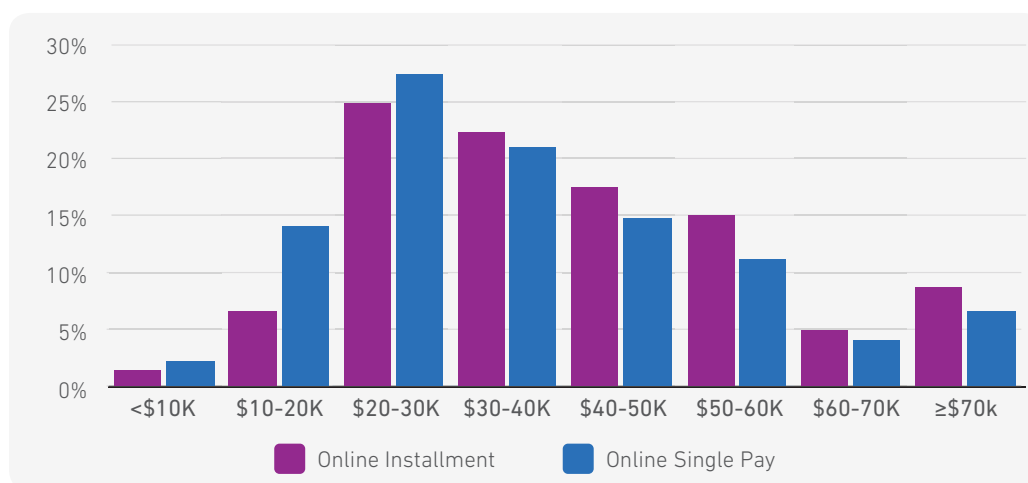
- Forty-five percent of online installment borrowers reported an annual income over \$40,000, while only 37% of single pay borrowers reported incomes in this range.
- Conversely, 15% of single pay borrowers reported an income less than \$20,000, as opposed to only 8% of installment borrowers.

Looking at the income distributions, it's clear that online installment borrowers have a higher average income than online single pay. Single pay lenders must only recover one payment. Installment lenders must take into consideration a series of repayments from the borrower over a longer time period.

This exposes lenders to increased risk due to possible income volatility for the borrower during the term of their loan.

Figure 12:

Online Borrower Income Distribution by Product 2018



Demographics of Applicants and Borrowers in 2018

The demographic differences between new applicants to the alternative financial services space and applicants seen in previous years were examined. One of the most noteworthy differences found was that first-time applicants in 2018 had considerably higher credit scores, 29 points higher on average, than applicants seen in 2017.

Table 7 shows the demographic differences in age, annual income, gender, marital status and credit quality between the applicants first seen in 2018, applicants with an observed application in 2017 and applicants with an observed application prior to 2017.

Table 7:

Demographics for 2018 Applicants

Demographic	First Observed Application was in 2018	Had an Observed Application in 2017	Had an Observed Application prior to 2017	All
Age	42	41	41	41
Median Net Annual Income	\$33,000	\$32,838	\$35,280	\$34,296
% Female	49.0%	51.5%	52.5%	51.9%
% Married	68.7%	66.6%	65.1%	65.9%
Average Vantage 3 Score	576	547	543	553

Table 8 shows the differences in age, median net annual income and marital status between storefront and online borrowers in 2018.

In 2018, online borrowers were more likely to be female, married and have higher traditional credit scores on average.

Table 8:
Demographics for 2018 Borrowers

Demographic	Online	Storefront
Age	43	45
Median Net Annual Income	\$36,000	\$24,000
% Female	58.7%	55.0%
% Married	67.7%	62.3%
Average VantageScore 3.0	544	539



Average Borrower with an Online Loan in 2018

Age:
43
Annual Income:
\$36,000
Average VantageScore:
544

Voices of Consumers

To get a better understanding of consumers who use alternative finance products, we conducted in-depth interviews with users of alternative finance products across the country with the intention of understanding their financial situation, how they got there and how they manage it. Our goal was also to learn how they apply for and use alternative finance products and which types of products they need.

We found consumers often struggle to pay bills and juggle these obligations by carrying balances and making minimum debt payments just to get by. They often cited experiencing a life changing event, such as job loss or major medical issues, that further stretched them too thin. Some also admitted to impulsive spending as being an issue.

When it came to selecting an alternative financial provider, consumers who found the privacy of the transaction appealing preferred using online providers, despite not doing much research on the lender prior to their transaction. Consumers who wanted a trustworthy and personable connection found the storefront providers more appealing.

When we asked what would be helpful for consumers, they cited financial education. They most often wanted to learn the following:

- Managing their finances and being more responsible with money, including spending prioritization and realistic budgeting
- Learning how to save money
- Checking, repairing and building credit
- Selecting credit cards and using them wisely

Location

Where Are Borrowers Located?

We examined borrower location by online loan count from 2014 to 2018. **Table 9** shows the top 10 states ranked by online loan count for 2018. State rankings are provided for the years leading up to 2018.

Partly due to their large population sizes, California and Texas have remained the largest markets for online lenders. Most of the other states have remained consistent over the last five years except for Michigan and Georgia, which experienced a notable increase over the last two years.

Table 9:

Top 10 Online Loan States by Loan Count 2014-2018

State	2014	2015	2016	2017	2018
CA	1	1	1	1	1
TX	2	2	2	2	2
OH	6	6	3	3	3
FL	7	8	4	4	4
MI	12	13	13	7	5
LA	11	5	5	6	6
AL	4	3	6	5	7
IL	10	10	8	8	8
MO	8	9	9	9	9
GA	20	16	20	12	10

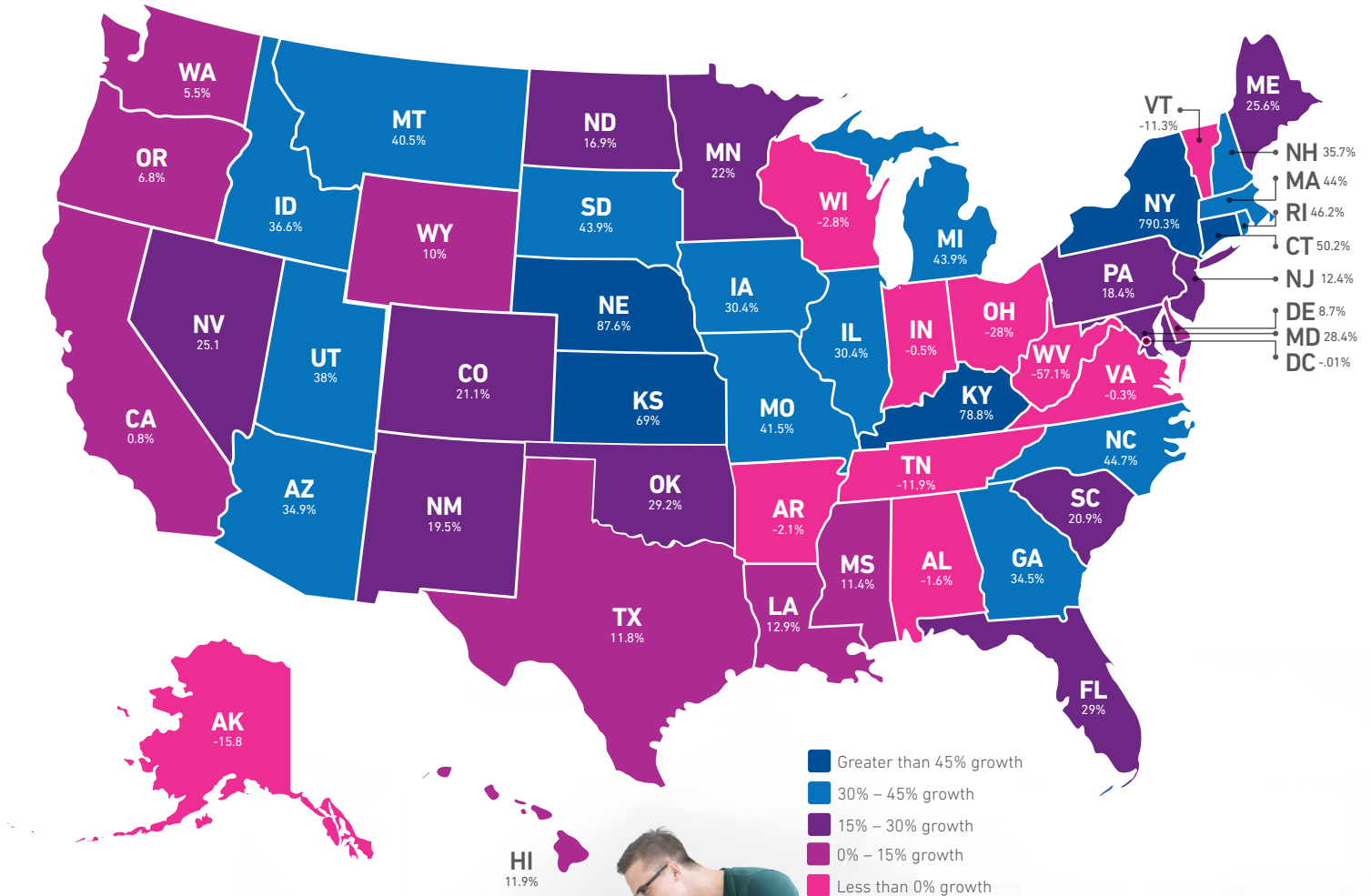


Loan location is determined by the borrower's address, not the lender's location.

We analyzed the growth percentage in the number of unique consumers obtaining alternative credit between 2017 and 2018 in each state. In particular, large increases were observed in the middle of the country from Nebraska to Kentucky.

Figure 13 illustrates the percentage change in volume of unique borrowers from 2017 to 2018 by state. For example, the number of consumers who opened a loan with an alternative finance lender in Kansas grew by 70% from 2017 to 2018.

Figure 13:
Growth of Unique Borrowers from 2017-2018



Closing

A Growing, Healthy Marketplace

Following is a summary of key insights resulting from the analysis conducted using a study sample of more than 25 million loans and over 350 million consumer loan applications from Clarity's alternative credit loan data.

- The online small-dollar installment market continues to significantly grow.
- Recent online installment loans are characterized by larger loan amounts, longer payment terms, and smaller scheduled payment amounts.
- There are early signs of deterioration in online installment loan performance.
- Over half of the online borrowers in 2018 were new to the alternative lending space.
- Applicants new to the alternative lending space in 2018 have higher credit scores than those previously seen. However, 2017 borrowers who migrated to traditional lending in 2018 also had higher credit scores than those who stayed with alternative financial services.
- California, Texas, and Ohio continue as the top three states for online lending in number of loans, while the largest growth in borrowers is in the middle of the country, from Nebraska to Kentucky.

If you have any questions or comments on this report, please contact ClarityMarketing@Experian.com

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.



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