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Payday lenders take aim at grubby end of US debt market

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Sasha Orloff is quite happy for his customers to leave him behind. If all goes to plan, in fact, low-income consumers taking short-term loans from LendUp, his online lending start-up, will eventually demonstrate enough of an ability to handle debt that they graduate to the mainstream banking system, granted credit cards, unsecured loans and mortgages.

"We focus on credit-building opportunities for people banks decline," says Mr Orloff, 38, a former microfinance expert at the World Bank who launched the San Francisco-based company three years ago. "We try to focus on how technology can make lives better and easier."

LendUp and its biggest rival Elevate, based in Fort Worth, Texas, are taking aim at payday and instalment lending — traditionally grubbier corners of America's $3.2tn consumer debt market. They are aiming to serve borrowers who cannot qualify for loans at bigger and better known online lenders such as Prosper, SoFi and Lending Club.

Payday loans are designed to bridge cash shortages of a couple of weeks. Instalment loans last longer, between two to three months, and are taken when the sudden expense — a broken boiler, a bereavement — runs to hundreds or thousands of dollars. Both are big business. Twenty-seven states allow single-repayment loans with annual percentage rates of 391 per cent or higher, according to the Pew Charitable Trusts.

"The people in this segment have to make the same decisions you and I make every day, but they have fewer choices and their choices are more expensive," says Frank Rotman, a partner at QED Investors, a Virginia-based backer of LendUp. "To completely cut them off feels like you're cutting off a huge population that needs access to credit."

In the UK, authorities have cracked down on payday lending, forcing operators to meet the watchdog's strict criteria for authorisation. But in the US, the overhaul is just beginning, with draft proposals issued in March by the Consumer Financial Protection Bureau, which began tosupervise the sector in January 2012.

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Under the new regime, designed to supplement a patchwork of state laws, lenders would have to determine at the outset that the consumer is not taking on unaffordable debt, or comply with various restrictions designed to ensure that the consumer can afford it. There are also proposed limits on the number of loans to be taken out by one customer — six to 10 per year — and restrictions on collections, so that lenders would be limited to two attempts to take cash from checking accounts without reauthorisation.

This is “very aggressive rulemaking” by the CFPB to “fundamentally alter the landscape” of payday lending, says Edward Mills, an analyst at FBR Capital Markets, who spent nine years on Capitol Hill in various financial services roles.

Mr Orloff and Ken Rees, chief executive of Elevate, say they have nothing to fear from the changes, noting that they are primarily aimed at lenders which try to skirt state laws by setting up on tribal reservations and claiming sovereign immunity. Spotloan of Illinois, for example, which offers instant loans of up to $800 across 34 states, is owned by BlueChip Financial, an entity governed by the laws of the Turtle Mountain Band of Chippewa Indians of North Dakota.

The new regime, which should be effective within two years, should mean that “bad actors leave the business, and better providers, more committed to longer-term relationships with the customer, will survive and flourish,” says Mr Rees.

That is also the goal of La’tesha Fields, a 43-year-old gospel singer from San Diego, California, who took her first $250 loan from LendUp in April after her landlord sold her house and she needed cash for a deposit. She has since taken out two more at $250 and has missed no payments, as she wants to move up LendUp’s “ladder” to the ultimate prize: reports to the three nationwide credit bureaux, and access to much cheaper credit.

Doris Edwards, a 50-year-old retail specialist from Dallas, Texas, hopes to scale that ladder within two years, which would mark a seven-year turnround after she declared bankruptcy after losing a job as a corporate trainer for a hotels chain. She is on her “maybe eighth or ninth” loan, having first borrowed to help her daughter with a utility bill.

That LendUp loan was for $500. She paid back $630 a month later. “I like the option there if I need it,” she says. “If I ever get in a bind.”

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