Trends in North Carolina's Consumer Finance Industry

Joint Legislative Study Commission on the Moderation of North Carolina Banking Laws and the Consumer Finance Act

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Overview

- Overview of consumer finance industry and regulatory structure
- Review of trends in consumer finance industry business models and profitability

OVERVIEW OF CONSUMER CREDIT INDUSTRY

Consumer Credit Environment: Key Questions to Consider

- Do North Carolina families have access to array of credit products offered in responsible fashion?
- What role does consumer finance industry play in meeting that need?
- Is consumer finance industry sustainable under current regulatory approach?
- Do consumers get a fair deal?

Consumer Finance Industry

- Regulated by NCCOB
  - Licensing
    - 6 lenders under 53-173 ($3,000)
    - 73 lenders under 53-176 ($10,000) with 483 offices
  - Examinations at office and corporate level
    - Examine sample of lender offices each year
  - Supervision and enforcement
    - Annual report data collection
    - Enforcement actions against payday lending subterfuges
    - Participation in industry conferences, etc.
    - Continue to defend Commissioner's decision in Advance America

Prior NCCOB research into consumer credit market

- NCCOB funded study to look at NC after payday lending (Nov 2007). Some key findings:
  - 9 out of 10 households believed payday lending was a bad thing
  - Former payday loan customers did not miss payday lenders and reported being better off without it
  - NC consumers had broad range of other products, including consumer finance loans
- Consumers generally satisfied with consumer finance lenders, but declining trend:
  - 95% of consumer surveyed ‘very satisfied’ or ‘somewhat satisfied’ in 2007, but dropped to 83% in 2009

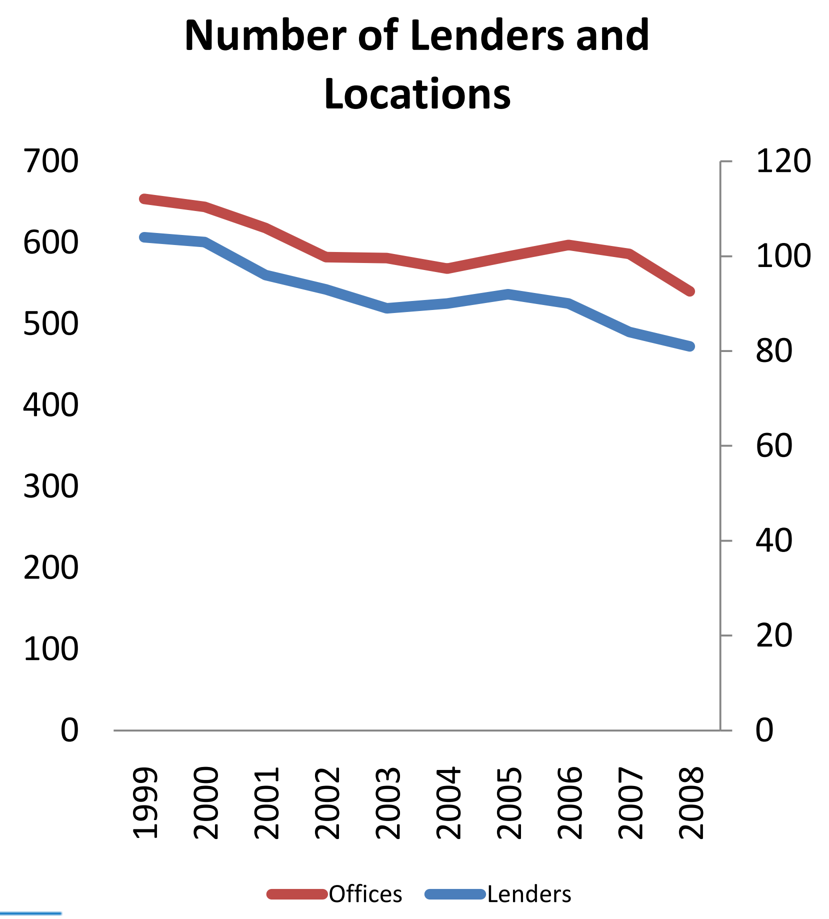
Boom and retrenchment of credit cards

- Explosion of credit cards to finance purchases in last decade
  - Revolving debt up 65% nationwide from 1998-2008
  - NC Consumer Finance receivables flat over same time period
- Credit contraction post financial system crisis
  - Credit card lines withdrawn and underwriting tightened
    - Total revolving debt down 10% in last year
  - New federal laws and regulations shifting cost structures of credit cards

TRENDS IN CONSUMER FINANCE INDUSTRY

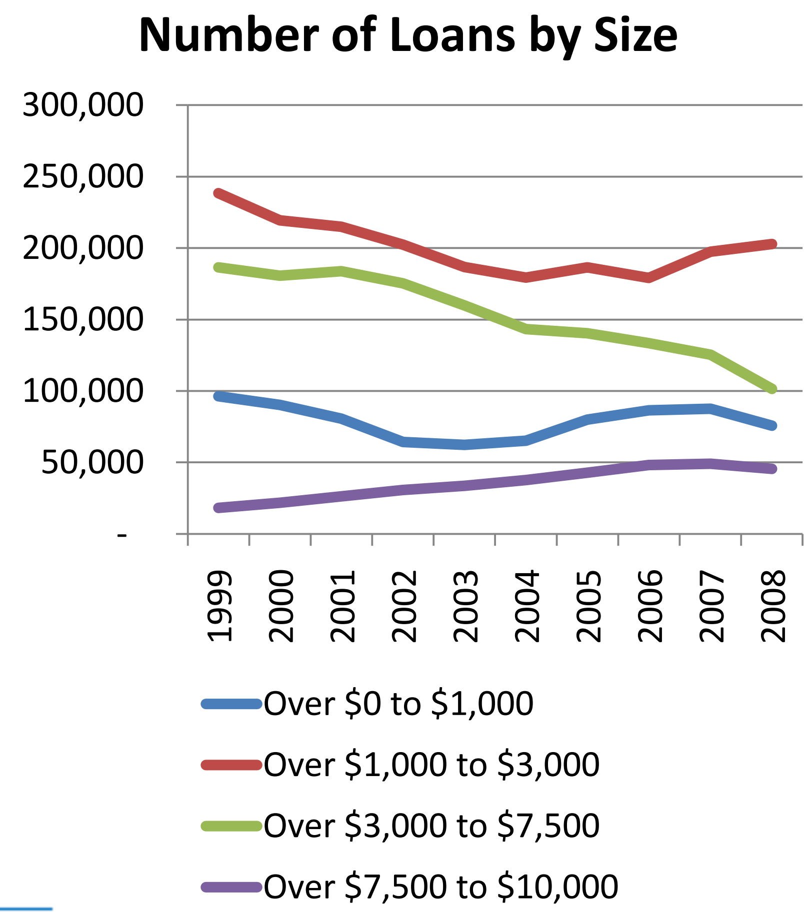
Steady Decline in CF Lenders through 2008

- 22% decline in number of lenders
- 17% decline in number of locations
  - 2008 decline driven by closure of Equity One and restructuring of WFF
- 2009 saw another drop
  - Primarily result of HSBC's departure from retail consumer finance market



Decline in loan volume matches decline in locations

- Trends by loan size inconsistent
- "Bread and butter" small loans rebounding after payday lending
- Large loans increased 149% in past decade, while mid-size loans dropped 46%

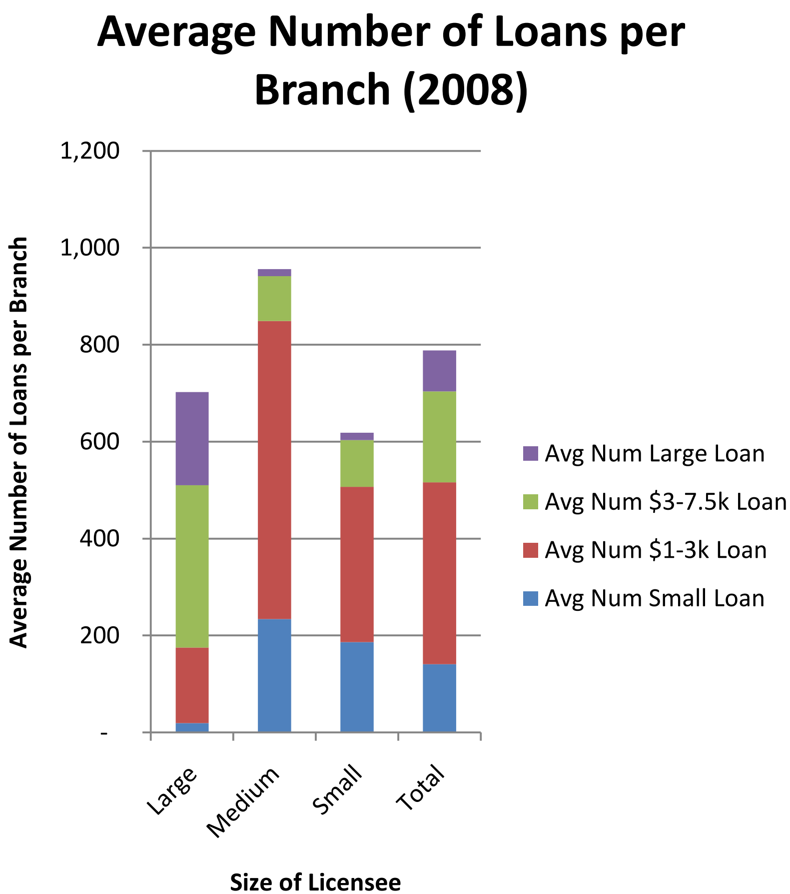


Consumer Finance Industry:
A Tale of Two Industries

- Concentration in two large lenders with significant retail branch network (approximately 100 offices each)
  - 40% of the market
- Remainder of small (1-6 offices) and medium (7-40 offices) lenders
  - 10-14 Medium size lenders= 40% of market
  - 60-70 Small size lenders = 20% of market

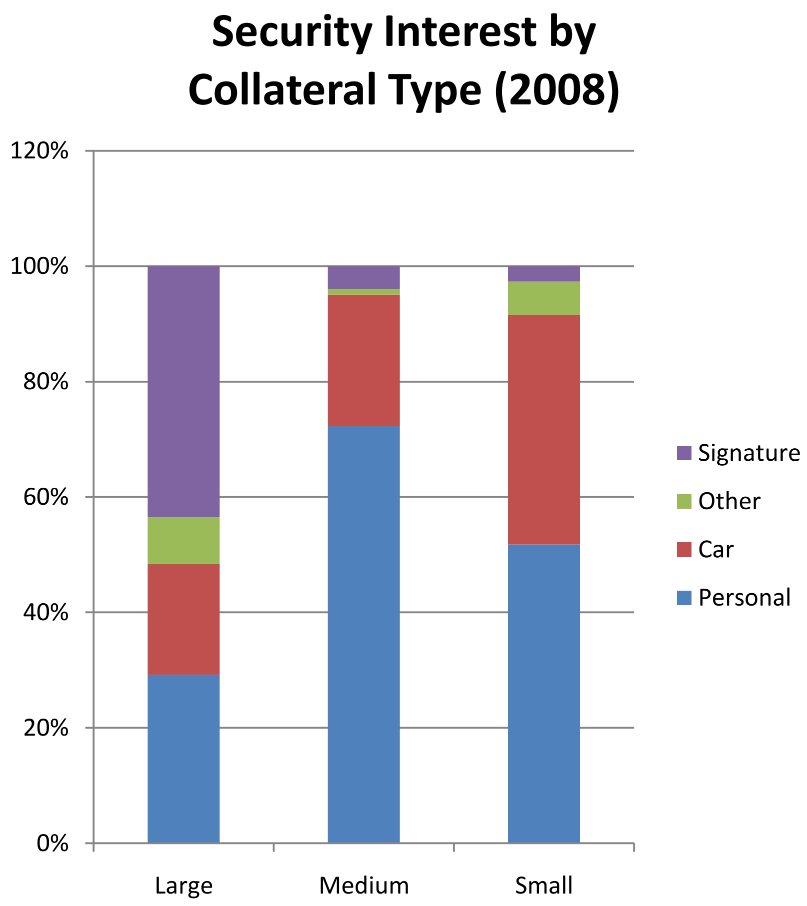
Large lenders focus on big loans; rarely make small loans

- 89% of all loans over $7,500 in 2008 were made by two large lenders
- 95% of all loans under $1,000 in 2008 were made by small and medium lenders



Small and medium lenders rely on collateral

- Over 40% of large lenders' loans were "signature" loans (86% of total)
- 96% of small and medium lenders' loans were secured by property
- Small lenders secure more loans with cars



Limits of Using NCCOB's Annual Report to Examine CF Lender Financial Condition

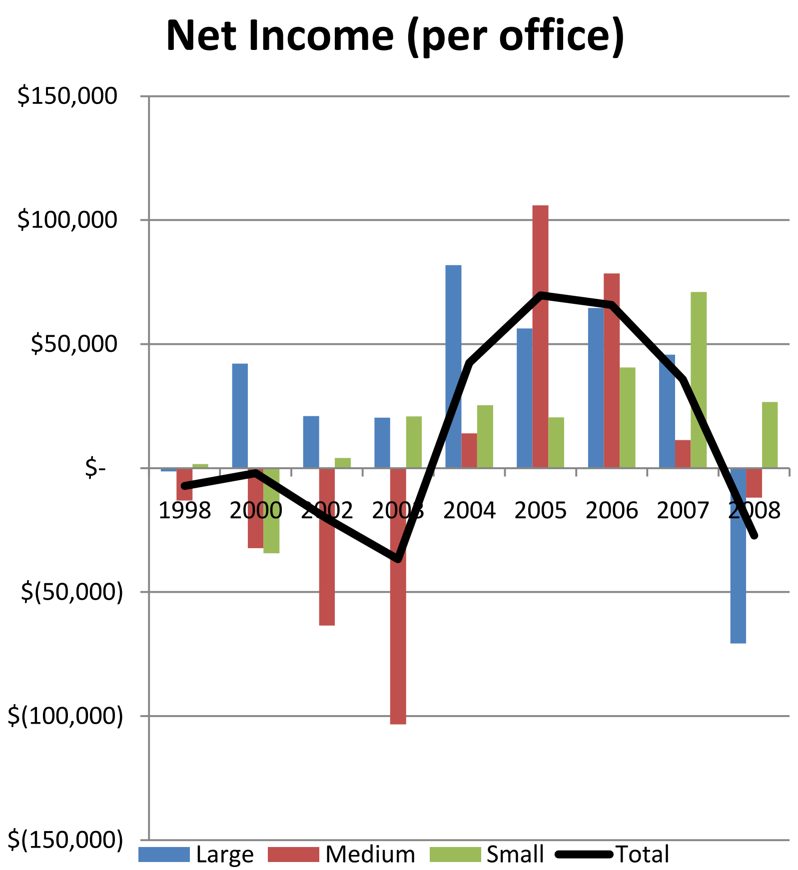
- Limitations of Data
  - Self-reported and unaudited
  - Variations in reporting by individual lenders
  - Does not include income from other business operations (e.g. indirect lending)
  - Differences in accounting and corporate treatment mechanisms
    - Capitalization of loan processing fee
    - Reporting of insurance income

Significant Balance Sheet Changes since 1998

- Loan receivables flat, even as number of offices down 18%
- Loan loss reserves up 111%, reflecting industry assessment of economic downturn
- Total assets down 5%
- Total liabilities down 11%
- Net worth of firms up 89%

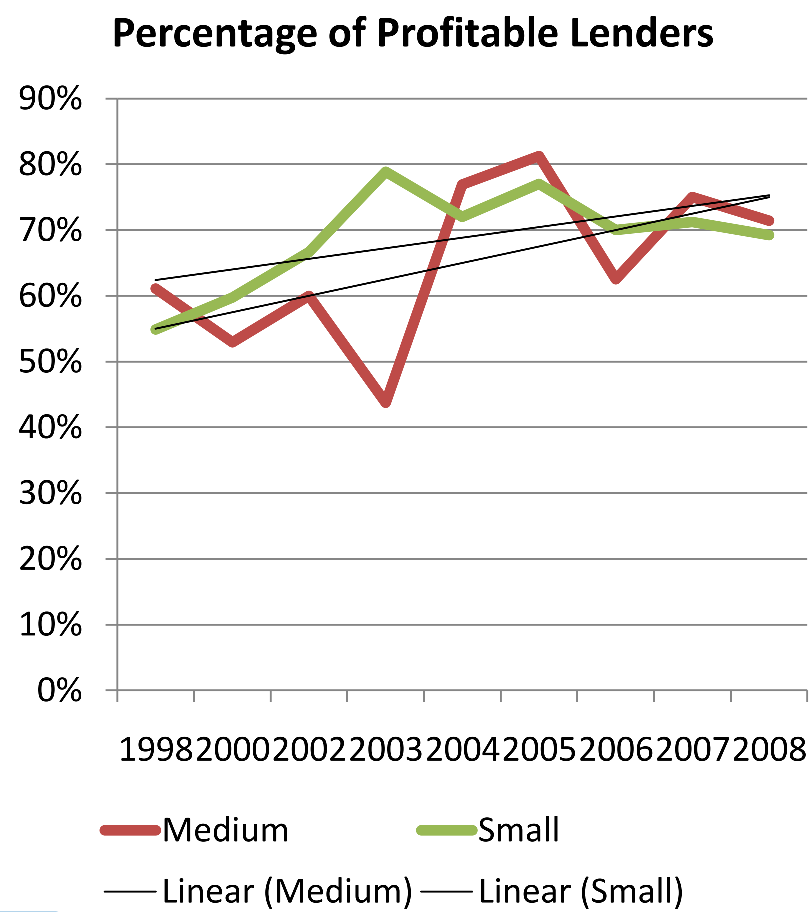
Industry net income tracks general economic conditions

- Large lenders profitable 1998-2007
- Significant variability in profit among medium size lenders
- Small lenders trending upward on profitability until 2008



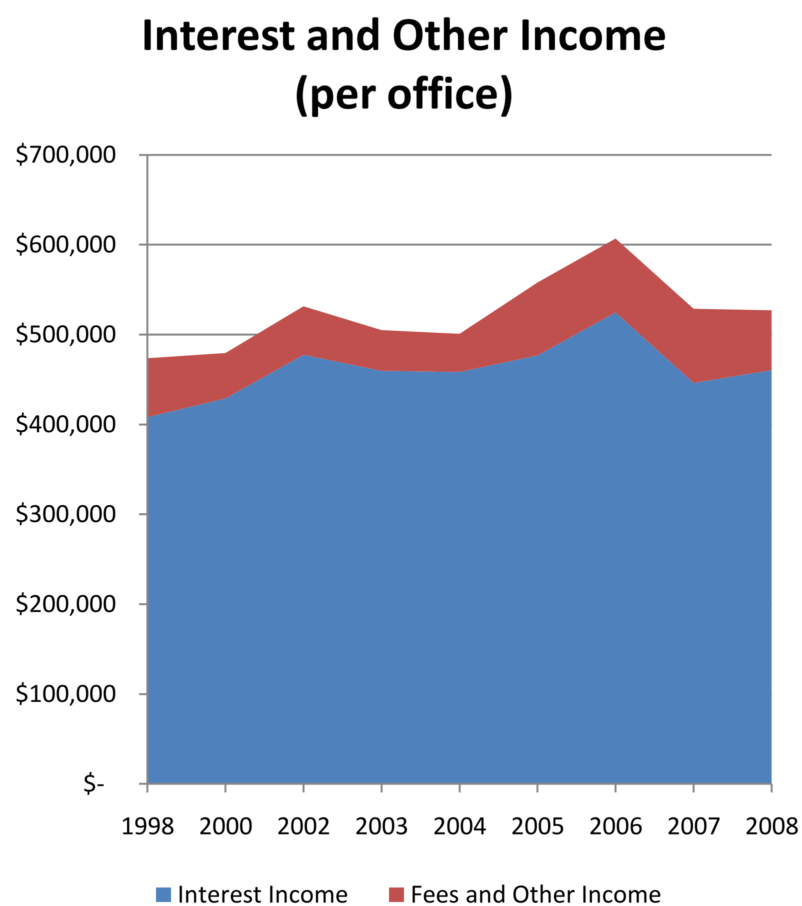
Profitability of Small and Medium Lenders

- Most lenders profitable in any given year
- Trend shows increasing percentage of profitable lenders



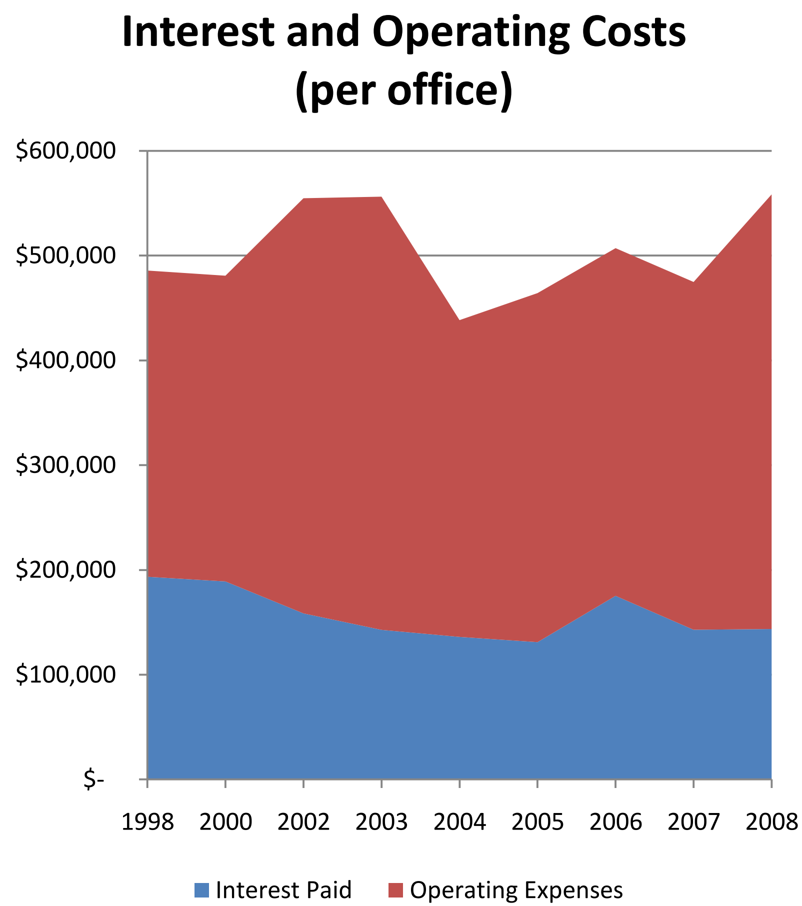
Industry Income

- Overall income (per office) increased 11%
- Interest income up 13%, with fee and other income up 2%



Industry Expenses

- Overall expenses (per office) up 15% since 1998.
- Interest expense down 26%
- Operating expenses up 42%



Conclusions

- Consumer credit market expanded and diversified in past decade and now retrenching as consumers struggle
- Consumer finance industry in North Carolina has consolidated and shrunk somewhat as a result downturn, but many changes appear driven by factors unrelated to CF Act
- Large lenders business model different from small and medium lenders -- focus on large, unsecured loans
- Annual report offers limited insight into profitability, but:
  - 2/3rds or more lenders report profitable and increased net worth
  - Profitability tracks economic conditions
- NCCOB anticipates difficult and lean years during “Great Recession” but does not yet see “sky falling” for overall industry survival

NCCOB Focus Areas for Consumer Finance Industry

- Risk-focused examination
- Close scrutiny of non-filing fees and insurance to avoid payday lending type subterfuges
- Expansion of annual report data collection and monitoring
  - Credit insurance penetration
  - Non-filing insurance and repossession activity
  - Indirect lending activities
  - Number of customers

Questions?