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MEDICAL DEBT AND SUBPRIME BORROWING

Findings from the Subprime Lending Data Exploration Project

This brief presents findings on the relationship between medical debt and subprime loan use from the Subprime Lending Data Exploration project. Using data from three sources — administrative data provided by subprime lenders as well as a survey and in-depth interviews with borrowers — the study explores the range of backgrounds and experiences among individuals who use subprime loans and the specific needs that drive borrowing. Medical debt is one of the main themes that emerged from the survey and in-depth interviews. Many individuals reported having such debt, either because they were uninsured for a period of time or because they had insurance that did not cover their expenses. These individuals used subprime loans to help cover medical costs or to cover regular expenses that may have originated from a health-related emergency. The findings suggest that the continuity and quality of health coverage are important factors in financial health and the use of subprime loans.

INTRODUCTION

The subprime, small-dollar lending market offers products such as payday loans to borrowers with weak credit histories and reduced repayment capabilities. This market is one of the most controversial components of the consumer financial system, and there is significant debate over whether these products are helpful or harmful to borrowers. Yet the emergence and rapid expansion of the market speaks to the existence of serious financial hardship and needs that are unsatisfied by the mainstream banking system. The Subprime Lending Data Exploration project examined the range of borrowers' backgrounds and experiences and the specific needs that prompt them to use subprime loans. The findings in this brief draw mainly from two of the project's data sources: a survey administered to subprime borrowers and in-depth interviews with borrowers.

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Among other findings, the project provides evidence of the importance of sufficient health insurance coverage for the population that uses online payday and subprime installment loans. (These terms are defined in Box 1; in this brief, "subprime loan" covers payday loans and subprime installment loans.) Almost all survey respondents had health insurance at the time of the survey, yet more than half carried medical debt. In interviews, borrowers told of medical events that occurred while they were between jobs and uninsured; they also related stories of insufficient coverage, including large deductibles, leading to financial hardship.

This brief focuses on the findings related to the interactions between health insurance, medical debt, and subprime loan use, and attempts to place those findings in the current policy landscape. (See Box 2 for a summary of other findings from the project.)[1]

BOX 1

WHAT ARE PAYDAY AND SUBPRIME INSTALLMENT LOANS?

Payday loans get their name from their structure: They allow borrowers to receive an "advance" on their next paycheck, to be repaid all at once. They are unsecured — requiring no collateral — so borrowers must show evidence of regular income and possession of a checking account to get them. Payday loans are small ($50 to $300) and short term (two to four weeks), with fees of $15 to $20 for every $100 borrowed. This fee translates into an annual rate (APR) of 200 percent to 400 percent. A payday loan may "roll over" for an additional fee if the borrower is unable to repay it by the due date.

Subprime installment loans are usually offered by the same lenders as payday loans. They can be somewhat larger (up to $5,000) and are structured so that the borrower pays off the loan over a longer period of time in regular installments, rather than in a single lump sum payment.

WHAT IS KNOWN ABOUT THE RELATIONSHIPS BETWEEN HEALTH INSURANCE, MEDICAL DEBT, AND SUBPRIME LOAN USE

Going without health insurance coverage is often costly and can lead to poor financial health. Out-of-pocket costs for health care are often so high that individuals without insurance are more likely to skip preventive care than those with insurance.[2] And many uninsured individuals who do pay out-of-pocket expenses eventually end up with medical debt.[3] This may be especially problematic for people with low incomes, who have lower rates of health insurance coverage[4] and thus larger out-of-pocket expenses, but fewer resources available to help cover those expenses. But even people with health insurance may face high deductibles and copays, as health care costs have risen over the past few years, and many employers — who provide health insurance to over half of U.S. adults — have passed on some of these costs to individuals.[5] When faced with large medical bills — due to lack of coverage or inadequate coverage — some indi-

1 See Nuñez et al. (2016) for more information on the project's findings.

2 McMorrow, Kenney, and Goin (2014).

3 Office of the Assistant Secretary for Planning and Evaluation (2011).

4 Barnett and Berchick (2017).

5 Claxton et al. (2017).

BOX 2

PREVIOUS FINDINGS FROM THE SUBPRIME LENDING DATA EXPLORATION PROJECT

The first phase of this project examined the reasons why people use subprime loans. It found that borrowers are quite diverse in terms of income and education levels. While many borrowers roll over their loans or default on them, the study uncovered a segment of borrowers — about one-third — who pay back their loans on time and rarely default.

Findings from the survey showed that most respondents had low credit scores, but nearly three-quarters had once had a prime credit score, and most used mainstream credit products, such as credit cards. About two-thirds of respondents reported taking out payday loans to cover regular expenses such as utilities and bills, food and groceries, and rent and mortgage payments, but 80 percent had recently experienced some sort of emergency. The survey respondents, overall, were financially vulnerable. Many had high debt loads, little or no savings, and a chronic inability to cover regular expenses. See the 2016 report on the project for more information.*

*Nuñez et al. (2016).

viduals turn to alternative credit products, including payday loans.[6]

The research summarized in this brief builds on the work cited above to expand the knowledge base around the role of medical debt in subprime loan use. This research has particular relevance given current debates about national health care policy. One important example is related to recent proposals to repeal and replace the Patient Protection and Affordable Care Act (ACA), which was passed in 2010. That legislation intended to expand access to health insurance and control health care costs. Those goals were to be met through several approaches, including imposing an individual mandate to enroll in health insurance, offering subsidies to employers and individuals, establishing state-based health insurance exchanges, removing cost-sharing for preventive services, and broadening the population who would be eligible for Medicaid.[7]

DATA SOURCES

The data used in the Subprime Lending Data Exploration project come from three sources: an administrative data set on subprime borrowing provided by Clarity Services, Inc., a part of Experian;[8] an online survey of borrowers; and in-depth interviews with borrowers. The findings presented in this brief draw mainly from the survey and interviews. The Clarity data were used to study the effects of the Medicaid expansion under the ACA on subprime loan use, as described in Box 3.[9]

The online survey was fielded to a subset of borrowers in the Clarity database. A small group of lenders covered by the database agreed to allow their borrowers to be contacted for the survey, and the survey was sent to all borrowers who took out a loan from one of those lenders. The survey took about 20 minutes to complete and included questions about demographics; employment, income,

6 Bickham and Lim (2015); Nuñez et al. (2016). Payday loan usage has also been associated with an array of negative health outcomes. See, for example, Sweet, Kuzawa, and McDade (2018).

7 For more information on the ACA, see Henry J. Kaiser Family Foundation (2013).

8 The Clarity data set has deidentified data on nearly 50 million individuals who have applied for or used subprime credit from hundreds of lenders operating in all 50 states. The data, reported by lenders, includes borrower demographics, loan types and terms, account balances, and repayment histories.

9 The Clarity data were also used in other analyses presented in Nuñez et al. (2016).

BOX 3

EXAMINING THE EFFECT OF THE MEDICAID EXPANSION ON SUBPRIME LENDING RATES

Based on the survey and interview findings, the research team decided to further explore the role of health insurance in subprime loan use using data from the Clarity database. The Clarity data set does not have any individual-level data on health insurance coverage or costs. The team instead examined the relationship between health insurance and subprime borrowing by doing an exploratory analysis of the influence of a change in health care law — the expansion of Medicaid under the Patient Protection and Affordable Care Act (ACA) — on aggregate borrowing behavior.*

With the passage of the ACA in 2010, the intention was to expand Medicaid nationwide to all adults ages 18 to 64 who live in households with earnings at or below 138 percent of the federal poverty level. However, the expansion became voluntary for states after the U.S. Supreme Court — in National Federation of Independent Business v. Sebelius (2012) — held that attaching states' continued Medicaid funding to their acceptance of the expansion was unconstitutional. Because of that, there is variation in whether states adopted the expansion — as of April 2017, 31 states had — and when states adopted it (before, on, or after the federal expansion date of January 1, 2014).+

The analysis exploited this variation and compared borrowing rates in counties along state borders that differed by whether or when their states adopted the expansion. Based on the survey and interview findings, it was hypothesized that counties in states that expanded Medicaid would have lower subprime borrowing rates than counties in states that did not expand Medicaid. Further, findings from other recent research have shown that the Medicaid expansion produced positive and statistically significant effects on a range of financial health indicators.‡

The analysis found a lower rate of subprime borrowing in counties that took up the Medicaid expansion than in counties that did not take up the expansion; the estimated difference is not statistically significant, however, and this result was quite sensitive to analytical specifications.

There are several possible explanations for the lack of a significant effect. One possibility ties back to the findings from the survey and interviews that indicated that the quality of health care coverage — which could not be examined in this analysis — may be a more important factor in determining subprime loan use. Another possibility is that there may be an effect, but it is difficult to detect with the data and methods available. Future research — which would benefit from a more rigorous research design — should explore this relationship further.

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*A prior study looked at the effects of the ACA Medicaid expansion on the use of storefront payday loans in California and found reductions in the number of payday loan borrowers, the number of payday loans, and the amount of payday loan debt in counties that expanded Medicaid compared with counties that did not. See Allen, Swanson, Wang, and Gross (2017).

+See Henry J. Kaiser Family Foundation (2012) for more information.

‡See for examples, Hu et al. (2016) and Breevort, Grodzicki, and Hackmann (2017).

and material hardship; assets, debt, and credit; and the use and perception of financial services, including payday loans. The survey was completed by 891 respondents.[10] Because the subset of lenders who agreed to participate in the survey is not representative of the full set of lenders in Clarity's database and because response rates were low, the survey results, though weighted to better reflect the distribution of characteristics available in the administrative database, may not be representative and should be viewed with caution.

At the end of the survey, respondents were asked whether they would be interested in participating in in-depth interviews. The research team conducted a series of one or two interviews — both in person and by phone — with 77 individuals who expressed interest.[11] The interviews were designed to get a better understanding of the personal and financial backgrounds and experiences of borrowers and what drives their need to borrow.

FINDINGS FROM THE SURVEY AND IN-DEPTH INTERVIEWS

One of the main themes that emerged from the survey and in-depth interviews concerned the relationships between health insurance, medical debt, and subprime loan use.[12] This section summarizes the main findings related to that theme, drawing from research presented in Nuñez et al. (2016) and the second round of interviews done with some of the borrowers.

As Table 1 shows, over 90 percent of survey respondents reported having health insurance — a rate comparable to that of the general U.S. adult population. Yet half the respondents also reported that they were paying off medical bills. Over half the adults in the United States receive health insurance coverage through an employer,[13] so this medical debt may have been incurred during periods when the respondent was out of a job and uninsured. This was the case for one interviewee, identified here as Dina. After relocating to a new city, Dina was able to find a job that offered health insurance, but her coverage did not go into effect right away. Before it did, Dina became ill and required emergency surgery. She was left with substantial medical bills from the surgery and used payday loans, credit cards, and overdrafts from her bank to manage her expenses.

Other interviewees reported having medical debt despite having health insurance because the plan did not cover their expenses. Some of these interviewees noted that their insurance provided protection against catastrophic medical bills, but it did not cover all their costs, such as prescriptions, or had very high deductibles. One woman, for example, described having a $2,800 deductible each year before the health insurance provided by her employer would start covering costs. Other

10 By a very conservative definition, the survey response rate (based simply on the roughly 41,000 emails sent and 891 respondents) was roughly 2 percent. This rate does not factor in the fact that only a fraction of individuals opened the email with the survey invitation. It is not uncommon for email as well as phone surveys conducted by organizations such as Pew Research or political tracking polls to have response rates in the single digits. See for example Silver (2014).

11 Forty-two of the initial 77 interviewees agreed to participate in a second interview 12 to 18 months after the initial interview.

12 Other themes emerged as well and are discussed in detail in Nuñez et al. (2016).

13 Barnett and Berchick (2017).

TABLE 1

SUBPRIME LOAN USE, DEBT, AND HEALTH INSURANCE, AMONG SURVEY RESPONDENTS

CHARACTERISTIC	PERCENTAGE
Has any debt[a]	97.1
Currently paying off medical bills	50.0
Has health care coverage	90.8
In the past year, received small-dollar credit from	
Payday loan	71.9
Internet installment loan	44.5
Storefront installment loan	11.6
Reason for most recent payday loan, among those who received one	
Regular expenses such as utilities, car payment, credit card bill, or prescriptions	*36.6*
Unexpected expense or emergency	*29.3*
Rent or mortgage	*15.1*
Food and other groceries	*12.3*
Special expenses, such as vacation, entertainment, or gifts	*4.2*
Other	*2.5*
Sample size	889

SOURCE: MDRC calculations from responses to the 2015 Clarity Survey.

NOTES: Sample sizes may vary because of missing values.
Italic type indicates that the responses are not from the full sample.
[a]Does not include debt from mortgages or home equity loans.

interviewees described having insurance plans with restrictive conditions. One individual, identified here as Lia, had health insurance, but her plan required her to pay treatment costs up front and then seek reimbursement. After a trip to the emergency room, Lia was left with a $6,000 bill. She started paying off the bill in installments but was frustrated by the late fees and interest she incurred. She decided to take out three online installment loans within a year to retire the debt more quickly.

Findings from the survey and interviews also show that while some borrowers use subprime loans to cover medical expenses (as was the case for the interviewees mentioned above), others use loans to smooth their incomes and cover regular expenses such as rent, utility bills, and food — almost two-thirds of survey respondents used their most recent loans this way (Table 1). But some of those loans may also have had origins in health-related emergencies or unexpected situations. That was

the case for Marcus, another interviewee, who used payday loans to cover his household expenses while serving as a full-time caretaker to his wife, who was suffering from an aggressive cancer. The medical treatment costs were covered by their health insurance, but since neither was able to work, their primary source of income was disability insurance, and they took out payday loans to cover their regular day-to-day expenses.

Analysis of the survey data found that having health insurance may provide some protection from financial hardship. A nonexperimental analysis of the predictors of loan use shows that individuals with health insurance were less likely than those without to have taken out their most recent payday loan to cover regular expenses. This association suggests that health insurance may play both a primary and a secondary role in preventing material hardship. Without health insurance, individuals may be forced to pay for medical expenses through credit options, including subprime loans, that can leave them with regular loan payments. Having to repay that debt may, in turn, lead individuals to borrow further because they have fewer resources available to cover regular expenses. Still, the research presented in this brief underscores that gaps in health insurance coverage, among those who have it, can also result in substantial financial hardship.

DISCUSSION AND POLICY IMPLICATIONS

The findings presented in this brief, taken together, suggest that the continuity and quality of health coverage are important factors in financial health and the use of subprime loans. The survey and interview findings highlight the role that medical debt plays in driving subprime borrowing. Although most survey respondents had health insurance coverage, the research revealed that subprime borrowing can result from gaps in coverage (either due to the extent of the coverage or periods between coverage).

For those who obtain health insurance through their employers, the availability of affordable transitional coverage for periods when an individual is in between jobs may be particularly important. COBRA — a temporary health insurance extension to cover a period after leaving an employer — is often available to employees who leave their jobs, but individuals are responsible for the full premiums in many cases.[14] Individuals can also purchase a health insurance plan directly, but again, they would be responsible for paying the full cost of coverage unless they qualify for a subsidy. Both options may make the cost of coverage prohibitive for individuals, especially those who use subprime loans, during periods when they are out of work.

It is also important to highlight that the qualitative research indicated issues with health-related expenses even among those covered by health insurance. Some of this may be driven by the rising costs of health coverage and employees' responsibility for paying a larger share of their medical costs than in the past. As of 2017, 81 percent of workers covered by an employer health plan had annual deductibles (an increase from 72 percent in 2012). And even those without deductibles were often responsible for other out-of-pocket medical expenses, such as copayments or coinsurance.[15] Expanding access to affordable and high-quality health insurance may be especially important for the segment of the population that resorts to subprime loans to help them from accruing medical debt.

14 COBRA coverage was established by the Consolidated Omnibus Budget Reconciliation Act of 1985.

15 Claxton et al. (2017).

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