Personal Loans: A Growing Role in Financial Wellness

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A personal loan can be a valuable financial-wellness tool, if used correctly - and technology is making it easier and cheaper to get one.

To explore how technology is opening up the personal loan market and the impact this has on consumers, MoneyRates.com conducted an extensive interview with Raul Tavares, Chief of Staff for LendingPoint.

LendingPoint is a financial technology company that pioneers new ways of using technology and data to make the lending process more efficient.

What does this mean to you?

Improved access and better loan rates that can help you manage your financial wellness, as long as you are careful to borrow responsibly.

>> See Today's Personal Loan Interest Rates

Benefits of Tech-Driven Lending

Getting a personal loan used to be very time-consuming. You'd have to call or visit multiple banks to find out about loan rates and other product features.

You'd have to visit a bank in person to fill out an application, and completing that application was often a very manual process.

Then, you'd have to wait for the lender to go through lengthy underwriting procedures before finding out whether or not you were approved.

Online lending made the process easier in two important ways:

1. Online lending platforms make it easier to apply for a loan

Tavares says online lending platforms like LendingPoint have made a big impact in a relatively short time. "Over the last ten years, we have seen the rapid entrance of online aggregators and online lenders," he told MoneyRates. "This entrance provides consumers an easy way to shop and find the most competitive rates."

Beyond allowing customers to do business with a lender online rather than in person, technology has made the application process go more smoothly. Now, lenders can research an applicant automatically, cutting down on the amount of information the applicant has to provide. After that, automation can streamline the underwriting process to give applicants an answer more quickly.

2. Data-driven underwriting methods allow more applicants to be approved

Speaking of the underwriting process, technology is also driving innovations in how lenders evaluate whether an applicant is qualified for a loan. This can bring additional information into consideration so an application does not have to live or die based on credit score alone.

New underwriting methods allow online lenders to address segments of the market that have historically been shut out from mainstream loan sources.

In the case of LendingPoint, Tavares explained "a large traditional bank has reasons why they typically do not lend to consumers below 680 or 700 scores, even though they probably could. For LendingPoint, we focus on near-prime starting at 585. In our direct-to-consumer segment, the average credit score is in the 650s."

> In effect, credit scores are backward-looking. They only paint a picture of an applicant's credit history. While that history is significant, it does not necessarily dictate the ability of a person to pay off a loan in the future.
>
> Automation now allows lenders to efficiently consider other pieces of information, and that opens up the possibility of a loan to many more applicants.

As Tavares explained it, "Credit scores are very important to the industry; however, they are not the only indicator of creditworthiness. For us, how a consumer earned that credit score is just as important as the score itself."

Consumers are responding to the greater access enabled by tech-driven improvements. LendingPoint says it fields 75,000 financing requests per week, and Tavares pointed out that the lending business in general is increasingly conducted online: "According to TransUnion, fintech lenders originate 38% of personal loans, growing from just 5% in 2013."

How Tech-driven Lending Makes Borrowing Cheaper

From a financial-wellness standpoint, the best thing is not that technology has made it easier to borrow, but that it has made it cheaper.

For example, while credit card rates have risen significantly over the past five years, as Tavares told MoneyRates "Financial technology companies have played a role in keeping personal loan rates roughly level."

The numbers bear him out. In 2014, people were paying an average of 13.19% on their credit card balances, while the average two-year personal loan rate was 10.23% - a difference of 2.96%.

Now, according to the most recent Federal Reserve data, the average credit card balance is charged 16.97% while the average two-year personal loan rate is 10.07%. Thus, the typical rate advantage for personal loans has widened to 6.9%.

There are a few possible reasons why personal loan rates have gone down a little while credit card rates have risen:

1. More efficient loan processing

Replacing the manual process of reviewing and evaluating applications with an online, automated process is more efficient, making it more cost-effective for lenders. The arrival of several online-lending platforms in recent years has meant consumers can now choose from a variety of lenders who can pass those cost savings along to consumers.

2. Better risk management

Part of the interest rate on a loan is used to cover the risk that some borrowers will default. If lenders believe data analysis can cut down on that risk, they don't need to add as much of a risk premium to their rates.

As an example, Tavares explained why it's important for LendingPoint to be able to look beyond just credit scores in assessing risk:

"For us, a big area of focus is income verification - something lenders don't often bother with. The more confidence we have in the information we have about an applicant, the better loan terms we can offer them."

This broader approach to underwriting may help the loan business adapt to the gig economy. As Tavares explained to MoneyRates, "An area of focus now for LendingPoint is working to understand small business/self-employed workers better so we can serve this market better. This is a market that's traditionally been under-served and over-charged by lenders."

3. More choices for consumers

LendingPoint is just one of many online lenders that have burst on the scene in recent years. Not only has this increased the number of lenders, but the nature of online lending is that these options are now typically available on a national basis.

Thus, there are not only more lenders out there, but consumers are no longer restricted to those who happen to have offices in their local market. More choices mean more chances to find a better deal; and with information online being readily available, it is easier for consumers to find that better deal.

Compare Personal Loan Rates and Apply Online:

Advertiser Disclosure

Bank/Institution	APY	Loan Term	Max Loan	
LendingClub	6.95 - 35.89%	36 - 60 months	$40,000	Type: Personal Loan SEE MY RATE Advertiser Comments
Payoff	5.99 - 24.99%	0 - 60 months	$35,000	Type: Personal Loan SEE MY RATE Advertiser Comments
freedomplus	5.99 - 29.90%	24 - 60 months	$40,000	Type: Personal Loan SEE MY RATE Advertiser Comments
LENDINGPOINT	15.49 - 35.99%	0 - 36 months	$25,000	Type: Personal Loan SEE MY RATE Advertiser Comments
upgrade	6.98 - 35.89%	36 - 60 months	$50,000	Type: Personal Loan SEE MY RATE Advertiser Comments
AVANT	9.95 - 35.99%	24 - 60 months	$35,000	Type: Personal Loan SEE MY RATE Advertiser Comments
PROSPER	6.95 - 35.99%	36 - 60 months	$40,000	Type: Personal Loan SEE MY RATE Advertiser Comments
OneMain Financial. LENDING DONE HUMAN	25.10 - 35.99%	24 - 60 months	$25,000	Type: Personal Loan SEE MY RATE Advertiser Comments

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Access + Affordability = Better Debt-Consolidation Options

Greater access and lower cost can make personal loans a better debt option than carrying an expensive credit card balance. This applies both to handling existing credit card debt and avoiding that debt in the future.

According to Tavares, 60% of LendingPoint's customers say they are using the funds for debt consolidation. Given the average 6.9% difference between the interest cost on a credit card balance and rate on a personal loan, refinancing credit card debt can somewhat ease the burden of your existing debt.

Also, when planning for an expense you know will take a while to pay off, using a personal loan rather than putting it on your credit card can help you save money from day one.

The benefit of using personal loans rather than credit cards for long-term debt goes beyond the rate advantage. The more structured repayment schedule of a loan makes it easier to plan around.

This is not just a responsible choice, but Tavares said it's appealing to customers. "Especially for the younger cohorts, such as millennials, our customer research has shown they prefer the transparency of personal loans. Also, the innate nature of personal loans drives financial responsibility and transparency - there is no open revolving line for you to spend money, and you know exactly how to budget the payments and for how long they are due."

>> Compare Personal Loan Offers Now

Financial Wellness: Using Personal Loans to Your Advantage

For all the benefits of online lending, it has to be used responsibly. After all, rates on personal loans can go as high as 35.99%, a very burdensome cost of borrowing.

Also, the ease of access to personal loans can have a downside if it leads to impulsive borrowing.

To use the greater availability of personal loans to your advantage, consider the following tips:

1. **Budget before you borrow**

   Never borrow money before you have worked out specifically how you will pay it off.

2. **Don't use debt consolidation to facilitate more borrowing**

   Using a personal loan to pay off credit card debt can be a great idea if it's part of an overall debt-reduction program. If you are simply doing it to free up your line of credit for more spending, it's a bad move.

3. **Match financing with the useful length of the purchase**

   If you're borrowing long term, try to make it for things that have lasting value.

4. **Shop around**

   Use the wider choices and access to information that technology provides to your advantage by comparing loan terms before you borrow.

5. **Focus on total cost**

   The cheapest payment is not necessarily the best option if it means a longer loan term that will cost you more in total interest. Also, focus on APR rather than just the interest rate to take into account the cost of fees.

The big changes technology have made to lending can be a win-win for online lenders and consumers - as long as consumers make the right choices.