

Topic #10: Anti-Predatory Lending Programs

What this topic covers:

- **Credit Union Practices Combating Predatory Lending**
- **Sustainable Innovation**

In recent years the United States has seen a proliferation of so-called “predatory” lenders such as payday lenders, rent-to-buy stores, title lenders, as well as the more traditional pawn shops, tax refund anticipation loans, or even “we buy jewelry” stores. These lenders can charge 500% APR or more on loan interest, even though sometimes the transaction is not even set up as a loan. For instance, with some payday lenders, a customer will come in on a Monday, cash a check for \$250 (post-dated until payday, Friday), and walk out with \$225 cash, having paid a “fee” of \$25. If this fee were treated as interest, the customer just paid 10% (\$25 is ten percent of \$250) for a loan that is less than a week. This works out to more than 520% per year (one week at 10% times 52 weeks in a year)!

Obviously, the customer (too often, one of our credit unions’ members!) is not going to get ahead financially paying such high rates. We at the Federation have looked for ways that our member credit unions can offer a product that can compete with the payday lenders and their ilk. In this “Best Practice” we review what 4 of our members have done, and discuss other possibilities for offering viable alternatives to predatory loans.

Three out of the 4 credit unions interviewed for this “Best Practice” indicated that their alternative payday loan service was sustainable, that it paid for itself. The 4th said that it was not, but is still a valuable service and that fundraising for it was easy.

Things that the 4 plans generally have in common are:

- not requiring a credit history, but requiring some sort of payroll deduction
- requiring very minimal documentation (no debt ratio calculation, for example)
- very quick turn-around on the loan application (immediately, or at most one day)
- very short repayment period, generally one month or less (that is, the loan is paid off fully in one month or less)
- frequent repayments, either weekly, biweekly or if the person is paid monthly, then monthly
- charging near the maximum of 18% APR allowed for most credit unions (one plan was significantly less).
- requiring that a member systematically save as a requirement for obtaining the loan
- maximum amounts of \$500 or less, and very low minimums, often less than \$50
- some plans encouraged “repeats”, other plans did not
- all plans offered some sort of financial literacy option and/or ability to graduate to the credit union’s mainstream lending program
- one credit union uses its computer system to freeze savings of the borrower-member (not always possible, due to computer systems and regulations)

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- the plans are quick to recognize losses (charging off) and maintain low delinquency rates.

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One credit union offers a “payday club” or “stretch plan” where the member joins a club paying \$4/week, and gets other benefits other than just the loan. By offering other benefits (telephone card, free ATM for example) the credit union avoids running afoul of the Truth-in-Lending regulation on disclosure of APRs (Annual Percentage Rates). The \$4 per week charge is not part of the APR, but does go a long way in covering administrative costs of the anti-predatory lending program.

Philosophical and other considerations:

- One credit union was astounded by the number of members that were also frequenting payday lenders. This seems to be a “blue-collar” phenomenon, the living from paycheck to paycheck, and not planning ahead.
- Two credit unions mentioned that the fact that a borrower-member’s savings were retained came in very handy when that member experienced a financial crisis: in both instances the member had forgotten or wasn’t aware of the fact they had the savings available.
- It is hard to fundraise for money to cover loan losses. It is much easier to fundraise for financial-literacy purposes. Therefore one way to make an anti-predatory lending program viable is to fundraise for the member counseling (financial literacy) aspect of the program, such as the loan officer’s time, the ancillary programs such as financial literacy training. By segregating the financial costs (bad debt expense and cost of funds) from these other costs, and using the interest income to cover only the financial costs, the program can be shown as being sustainable.
- When people need money, they need it now. Payday lenders and others have flourished because they recognize and meet this need. Many payday lenders provide clean, hospitable environments (for example with flowers and landscaping) for their customers, making them feel welcome. They treat their customers with respect, and get their repeat business. We credit unions can learn from this—we need to provide a fast turnaround and friendly service.
- Notwithstanding the previous bullet point, we credit unions will not be able to serve all the customers that our competitors (the predatory lenders) do. We do not make the spread (500%) that they do. They can take much higher credit losses than we can. However, we still can serve many of our members, and this is the point of offering an alternative program to combat predatory lending. The interest we earn on a one-month-or-less maturity loan for a minimal dollar amount is small.
- Payday lenders are constrained by law: they cannot offer their customers a savings option since they do not have financial intermediation licenses (bank, thrift, or credit union charters). We can. This is a way we can compete. Saving is a way out of poverty.

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- Payday lenders usually have no interest in graduating their customers to improved credit status. We do. This is a very important “added value” we offer our communities. We can fundraise for this.

Conclusion: Anti-predatory lending programs work. Our members have found that they are sustainable and assist in helping members out of poverty. They allow our members to meet their mission.