Banks at the Crossroads: How to Create Economic Justice for the Under-Banked

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ICCR's engagement with the financial services sector stretches back nearly four decades. At the heart of our advocacy is the goal of bringing greater stability to global financial systems in order to promote sustainable development that serves the needs of the common good. In dialogues with banks and other lending institutions, regulators and credit agencies, ICCR members have focused on reducing the risks inherent in certain transactions, for both the financial institutions and their customers, while increasing the access and affordability of capital for those who need it most.

Federal deregulation in the 80s led many mainstream U.S. banks to abandon small consumer loans, which generated only a marginal profit and replaced them with high interest rate credit cards with insufficient underwriting, leading to high defaults, bankruptcy, and the growth of an "under-banked" population without access to traditional credit products. To meet the needs of the under-banked, a "fringe" financial services industry emerged in the 90s with offerings such as payday loans, pawn loans, direct deposit advance loans, auto title loans, and non-bank installment loans which all carry high interest rates and fees. While marketed as emergency credit for under-banked customers to help bridge them across paychecks when unexpected expenses surface, the interest rates and fees associated with these loans can easily trap borrowers in a dangerous cycle of perpetual debt.

Both payday and deposit advance loans carry hefty fees and interest rates in the range of \$10-\$20 per \$100 borrowed, translating to annual percentage rates (APRs) of roughly 300%. Typically, borrowers must repay the full amount of these loans within two weeks or face additional fees. In the case of direct deposit loans, lenders have direct access to a customers' bank account for repayment from a direct deposit.

Of the two products, payday loans are viewed as more dangerous for economically vulnerable customers and have been branded as "predatory" by state and federal regulators. Fifteen states and the District of Columbia have passed laws that effectively make payday loans illegal. These products are used by (and marketed to) individuals who are more often than not: a) less educated; b) living in larger and lower income households; c) more likely to be African-American and living in the South.

Recently, a handful of mainstream banks have moved into this quick and small-loan market with "deposit advance" products that have disturbing similarities to payday loans. The 2008 financial crisis and ongoing bleak U.S. economic outlook have only increased the pool of desperate borrowers in need of affordable credit solutions.

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"Most of the individuals resorting to direct deposit loans don't qualify for credit cards or traditional lending products and have trouble getting the money they need to cover emergencies, such as a health care crisis or a car in need of major repair," said Sr. Nora Nash of the Sisters of St. Frances of Philadelphia. "We are encouraging the banks we engage to use their vast resources to come up with better, safer products that can help these people, most of them hard-working, access affordable credit that won't entrap them in long-term debt."

Four banks currently offer direct deposit advances. Wells Fargo offers its "Direct Deposit Advance", US Bank a "Checking Account Advance", Fifth Third Bank offers an "Early Access Now" advance, and Regions Bank a "Ready Advance".

These banks are at a clear crossroads: how do they service the need for quick and reliable credit in ways that will preserve the financial health of these high risk customers without sacrificing their own financial health? "Banks offering deposit advances frequently justify the high fees and interest rates they charge as the fair cost of supplying unsecured loans to customers with no other credit alternatives," said Jeff Perkins of Friends Fiduciary, "But these rates aren't practical or sustainable. We are asking the banks to fully disclose and justify these rates both to their customers and to us as their investors. We are convinced there are ways to service the needs of this community that will improve and not exacerbate their situations."

Anita Green, of Wespath Asset Management, spoke to the changes ICCR members are seeking. "As a sensible first step, we're asking that the banks we hold adhere to the new leveraged lending guidelines developed by the FDIC (Federal Deposit Insurance Corporation) and the OCC (Office of the Comptroller of the Currency) which are intended to ensure safe & sound lending activities."

Released in May of this year, the Interagency Guidance on Leveraged Lending has two key parts. The first calls on banks to do more thorough underwriting of deposit advanced loans, based on a borrower's ability to repay a loan without re-borrowing. The second major provision calls for a "cooling off period" – in essence a cap on the number of times a borrower can take out a loan during a 12 month period – of one loan every 2 months to reduce the risk of repeat borrowing.

Said Sr. Susan Mika of the Socially Responsible Investment Coalition, "While the guidelines are a clear improvement, we still have a ways to go to achieve a fair product; the guidelines fail to address the issue of sky-high interest rates, and that's where customers are really being hurt."

Improved tracking of customers using these products, perhaps through a common database, and financial literacy programs designed to prevent borrowers from falling into the "debt trap" are other programs banks could explore to help put customers on the path to financial independence.

Frank Rauscher of Aquinas Investments, who has been engaging most of the four banks on responsible lending issues for 6 years points out, "One model the banks may want to consult is the 36% APR cap on payday loans that protects members of the military and their families. At roughly twice the APR charged for credit cards, this cap would still provide banks with a very reasonable profit. What is clear is that we need a better understanding of their formulas for risk-based pricing."

Shareholders also point to the short-term loans offered by credit unions as a "best practice" model that banks could follow. The Federal Credit Union Act and the NCUA Rules and Regulations set the maximum interest rate federal credit unions can charge on loans and lines of credit at 15% per year, a fee which also includes all finance charges.

"At bottom it becomes a question of economic justice," said Nash. "As faith-based investors we want to ensure that everyone has an opportunity to improve their lives and the lives of their children. We know there is a way to make fair and affordable credit available to these people that will benefit them, and by extension, the greater economy. We are asking the banks we own to help make it happen."

According to the Consumer Financial Protection Bureau (CFPB), "payday borrowers are indebted a median of 55% (or 199 days) of the year. For the majority of payday borrowers, new loans are most frequently taken on the same day a previous loan is closed, or shortly thereafter." 65% of direct deposit customers also accrue overdraft fees. The typical payday customer with more than $3,000 in advances goes a scant 12 days or less between paying an old balance and taking out a new advance.