

Roundtable 2 Financial Services Matrix

Introduction

The matrix below shows different types of financial institutions and the services they provide to low income households. The format tries to emphasize the overlaps and gaps in services among institutions and offers a means of comparison among the more traditional depository institutions and fringe lending institutions. Interest rates, fees, and levels of services vary widely among institutions and services. Many low income households must pay high rates and fees for these financial services. Typical interest rates for each category of institution along with descriptions of some of the terms used are included in the footnotes.

The direction that the non-banking lending industry appears to be heading is towards expansion of services offered and the number of institutions. For example, many check cashing companies are adding loan products such as payday loans, and additional non-loan products, e.g., postage, notary, bus passes, lottery tickets, lamination, money orders, bill payment, etc., e.g., credit insurance, bus tickets. Many are also accepting electronic benefit transfers as part of expanding services. Additionally, research shows that the numbers of fringe lending institutions are increasing in low-income neighborhoods.

There have been efforts to regulate the various non-regulated fringe-lending industries. These efforts have been met by fierce counter efforts in states such as Florida and Texas, where the fringe-lending industry is most very prominent. Lenders have found regulatory loopholes like sale-leaseback methods in order to continue lending at high interest rates (with added fee schemes.) It should also be noted that though banks are heavily regulated, they too offer a wide range of loan products with varying interest rates and fees depending on the assets and income of the borrower and type of loan being made.

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FINANCIAL SERVICES MATRIX							
INSTITUTIONS							
	Depository		Fringe Lending				
	Credit Unions	Banks/ Savings and Loan	Check Cashier/ Payday Lender	Collateralized Lenders	Rent-to-Own	Finance Companies	Mortgage Companies
Services (general)							
Check cashing	√	√	√				
Wiring money	√	√	√				
Money orders	√	√	√				
Bill payments	√	√	√				
ATM	√	√	√				
Credit cards	√	√					√
Financial (lending)							
Small, short-term loans (up to six months)	√		√	√		√	
Personal loans (furniture, auto, etc.) up to five year term	√	√		√	√	√	√
Small business loans (up to \$5,000) up to three-year term	√	√					
Sub prime home equity loans, debt consolidation and refinancing		√				√	√

	Depository		Fringe Lending				
	Credit Unions	Banks/ Savings and Loan	Check Cashier/ Payday Lender	Collateralized Lenders	Rent-to-Own	Finance Companies	Mortgage Companies
Savings plans – savings accounts, IDAs, etc.	√	√					
Checking accounts	√	√					
Investments – CDs, stocks, retirement	√	√					
Other Financial							
Service sales (sale of phone cards, postage, travel, etc.)			√				
EBT	√	√	√				
Training							
Financial literacy	√						
Credit repair	√						
Credit counseling	√						
Savings and investment counseling/advice	√	√					
Other (non-financial)							
Stored Value System (smart card)		√					

Institutions

Depository institutions, particularly banks, tend to not to make loans for less than \$1,000 and/or terms of less than a year.

Check cashers charge a fee for cashing checks. They charge different rates for cashing government, payroll and personal checks. The fee may be anywhere from up to 3% of the face value of a government or payroll check to 12% for a personal check. The check cashing institution may charge a fee for an identification card if the user intends to use the service regularly, and may charge a higher fee if the user does not have what they consider “acceptable” identification.

Payday lenders are often stand-alone institutions, or often part of a check cashing institution. They make loans that are comparable to an advance of a person’s paycheck or part of the paycheck amount. The lender agrees to defer the deposit of the borrower’s check for a certain period of time of up to 30 days, similar to writing a post-dated check, not to be cashed until the date agreed upon. These lenders usually require proof of employment and a checking account. They make short-term loans of between \$100-\$400 with 300%-900% APR, based on fees charged, if the loans are roll over throughout the year. These lenders are not subject to usury laws in many states and the availability of products and services is often a function of state regulations. These lending institutions allow for easy roll over of the loan with associated fees and higher interest rates. The fees for payday loans are often in the range of 10% to 17% of the loaned amount.

Collateralized lenders are a variety of lending operations that either finance the purchase of goods they sell or lend money in exchange for property or title to property. Examples of collateralized lenders are:

Pawn shops lend money on items that have value, including TV’s, stereos, jewelry, tools, musical instruments, computers and accessories, recreational equipment, boats, tractors, motorcycles, cameras, etc. Borrowers bring in items that they want to borrow against. The amount of money the borrower receives depends on the make, model and condition of the item. Pawn shops lend anywhere from 20% to 65% of the resale value of the item. The loan is due to be repaid in thirty days but the loan can be extended every month by paying the interest. Pawn shops vary in the fees and interest they charge and are regulated in some states. As one example, a Virginia pawn shop charged a \$2.00 one-time service charge, a 2% storage charge and 10% per monthly interest rate or finance charge.

Title lenders lend money secured by the borrower’s clear automobile title. Title lenders may charge 25% or more interest per month. Typically the loan is for thirty days. A borrower may extend the loan for a subsequent month if he or she pays the monthly interest due for the previous month. It is common that a borrower will rollover a title loan several times. There are sometimes additional fees and often times higher interest rates associated with these rollovers. If the borrower is unable to pay the monthly interest or principal that is due, the title lender takes possession of the automobile. Upon sale of the automobile, some lenders retain the proceeds of the sale even if the value of the automobile exceeds the loan amount. Most title loan companies require proof of employment.

Sale-leaseback operations resemble payday lenders, except the borrower signs a paper "selling" personal property to the lender for the amount borrowed but gets to keep the property for a "rental" payment usually around 1/3 of every \$100 borrowed. Effective annual interest rates for these transactions can exceed 700% as they are not subject to usury laws in most states.

Rent to Own companies "rent" merchandise, although the structure of the transaction is more like a loan because of the interest and credit insurance involved. These businesses charge a weekly or monthly rent for a stated period, after which the property is owned by the "renter". Because the store is "renting" instead of selling, the store does not have to report how much it is charging in interest. If a borrower is late with a payment, there is no legal limit to how much interest the store can charge in "finance charges", although the company usually repossesses the rental property.

Finance companies are regulated non-bank lenders that provide unsecured short-term loans to high-risk borrowers charging the maximum allowable interest rates and fees. They are sometimes affiliated with conventional banking and insurance institutions. They often encourage refinancing and loan consolidation at rates that are higher than if a borrower went to a depository institution.

Mortgage companies in the fringe lender category specialize in sub-prime (sometimes referred to as non-prime) home mortgage and home equity loans and, in a few instances, car loans. They target those with impaired credit, employing numerous techniques to inflate the amount a person can borrow and charge high interest rates and various fees. Many of these companies are associated with banking institutions that offer additional financial services. Sub-prime mortgage rates are usually 4 to 6 or more percentage points higher than the prime lending rate.

Services

Credit Insurance is often provided by lending institutions receiving a commission on the sale of the insurance. Lenders collect, on average, 30-40 percent of a borrower's first year's credit insurance premium as a commission. Credit insurance is usually structured as a fee to the borrower and sometimes borrowers have no choice and/or may not even know they are purchasing credit insurance as part of their loan. Many fringe lenders require credit insurance even in situations where the risk of default does not warrant the purchase of the credit insurance. In a pawn situation, if the borrower defaults on the loan, a pawn broker often sells the property pawned and collects the insurance. Some credit insurance is non-filing insurance which protects the lender who does not file a UCC, thereby self-insuring against risk of not perfecting a security interest in the property used as collateral. In the mortgage industry, single-premium credit insurance (SPCI), where credit insurance premiums are financed into the loan through a single up-front payment, is the most significant predatory mortgage lending abuse. There are some states that regulate credit insurance or some aspects of credit insurance. Premiums vary from state to state. Some types of credit insurance include:

- property coverage
- credit life
- credit disability
- involuntary unemployment insurance.



Electronic Benefits Transfer (EBT) is a vehicle for delivering government benefits to a financial institution using electronic technologies. Under EBT, the government wires funds into an account. The account holder (beneficiary) has limited access to these funds.

Smart Cards, first developed in the 1970s, are credit-card sized plastic cards with an embedded computer chip. Their applications combine use in telecommunications (mobile phones, DirecTV), financial services (electronic purses, bank cards, online payment systems), retail, transportation, and healthcare (insurance card) industries. The card holder puts a certain amount of funds in an account that is recorded on the card and then draws funds from the card for various uses.