

**CUNA'S
ALTERNATIVES TO PAYDAY
LENDING TASK FORCE
OF THE
STATE ISSUES SUBCOMMITTEE
OF THE
GOVERNMENT AFFAIRS COMMITTEE**

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INTRODUCTION

In 1999, payday lending was addressed by 26 state legislatures. “Payday lending” refers to single-payment, short term (13-17 days), small loans (\$100-\$500) based on personal checks or share drafts. In a typical payday loan the consumer writes a personal check, or share draft, drawn on a financial institution for the amount borrowed plus a fee. The fee, stated as a percentage of the check or of the loan, generally \$15/\$100, usually translates into triple digit annual interest rates. The lender agrees to not deposit the share draft until the consumer’s next payday. When the loan is due, the borrower can redeem the share draft for cash, allow the share draft to clear through the credit union, or pay another fee, again \$15/\$100 to extend the loan for another two-week period. This extension, or “roll over”, is usually where the trouble begins.

In an effort to comprehensively investigate how this issue could impact credit unions, the State Issues Subcommittee began a fact finding mission that included meetings with payday lenders, credit unions offering alternatives to payday lending, academics who study the issue and credit union lobbyists who are working the issue at their state legislatures. The subcommittee also gathered materials from various consumer groups and payday lender regulators.

The Subcommittee's Findings:

- A Task Force of credit union lenders with expertise in low balance, convenience loans should be assembled to develop a model, or models, of lending products and credit counseling programs that credit unions could offer as an alternative to payday loans.
- Credit unions need to do more to educate their members regarding the high cost of payday lending.
- Credit unions need to do a better job marketing their products and services to members so that the members are better aware of the options available and the value of using their credit union.
- Credit unions need to reach out to the communities that have embraced check cashers, pawn shops and payday lenders as their regular financial institutions, and be sensitive to their unfamiliarity and distrust of traditional financial institutions.

Consequently, the Alternatives to Payday Lending Task Force was established and this handbook is a result of their work. The objective of this document is to provide a framework using several samples of lending products and debt counseling programs as alternatives to the payday loan product. Credit unions across the country can adopt a sample

program, with or without modifications, to meet their members needs.

SAMPLE ALTERNATIVES TO HIGH COST PAYDAY LOANS

The goal of this handbook is to provide ideas that credit unions can modify, expand upon, or use as a catalyst to come up with their own ideas for programs and products that will meet the urgent, short term needs of their membership.

This handbook offers a range of ideas from implementing internal policies to forming a Credit Union Service Organization (CUSO) that directly competes with check cashers and payday lenders.

Through this range of options, the Task Force members believe that every credit union can find an alternative to high cost credit to meet the needs of their membership.

The Task Force offers these ideas recognizing that not all payday borrowers can be served by credit unions, nor do they necessarily want credit union services. Many payday borrowers choose high cost loan products for reasons of convenience or to avoid using a traditional financial institution. For those consumers who reluctantly turn to payday borrowers because they believe they have no choice, credit unions can make a difference. Credit unions must reach out to these consumers.

People-Helping-People Loan

The Orange County Teachers FCU (OCTFCU) recognizes that a credit union member may at some point need emergency credit and yet not meet standard credit guidelines. To accommodate the special needs of their Membership, OCTFCU established the People Helping People (PHP) Program.

The People Helping People Program provides up to \$500 to credit union members in hardship situations. These loans are generally for six months and are intended to provide funds for immediate personal or emergency expenses, such as food, shelter, utilities, or other urgent needs. OCTFCU does not actively market or advertise the PHP Program. Instead, the PHP Program is managed by way of internal procedures and training that encourages branch managers to recognize members' needs in emergency situations and offer the PHP loan option where appropriate.

The PHP loan is not a standard loan product of the credit union and is not treated like other loans in terms of credit criteria, loan terms, or collection efforts. Neither interest nor fees are charged on the loans, and in the event of delinquency, formal collection efforts are not taken. Charge-offs are carefully monitored, however, to ensure that losses do not exceed acceptable levels. So far OCTFCU has experienced loss ratios on PHP loans that are

comparable to those experienced on its credit card portfolio.

\$300 Micro Loan

In 1998, Carolina Trust FCU was notified by one of its sponsor companies that its employees were frequently coming to the payroll office seeking advances on their paychecks. Working with the sponsor company, the credit union developed the Micro Loan Program, a six month, 18%, \$300 payroll deduction that does not require normal underwriting procedures.

Generally, the loans are paid back in two or three months, decreasing the amount of interest actually paid. By charging a higher rate than that offered to persons with a good credit rating, the credit union is able to provide reasonably priced credit to those on the margin.

To apply for this loan, the employee simply fills out a brief application. The credit union contacts the employee's sponsor company to verify current and potential future employment. Once this is done, the credit union sets up a payroll deduction plan and releases the funds to the member.

If a member requires more than \$300 to solve a financial crisis in a particular emergency, such as car repairs or a broken down refrigerator, the credit union will provide

additional funds. Under these circumstances, the transaction, and the need for excess funds, is very well documented.

For repeat borrowers, the loan officer spends as much time with the member as that individual will allow. When appropriate, the member is referred to the credit union's free financial counseling department to address any of the member's financial problems that may lead to repeat Micro Loans.

The credit union encourages members participating in the Micron Loan Program to utilize the free financial counseling services which assist the member with budgeting, bill payments and systematic savings until the member is completely out of debt.

The Micro Loan Program has proven to be not only a great program for the credit union's members, but the sponsor companies also find it to be an additional incentive for offering credit union membership to their employees.

Shared Branches As A Vehicle to the Underserved

One of the primary reasons payday borrowers give for choosing a high cost payday lender over a traditional financial institution is the convenience of location. Payday lenders are generally located in strip centers, malls and underserved neighborhoods.

Credit union shared branching facilities, which are simple storefronts generally located in strip centers and other convenient areas, would meet this need for convenience. Discussions are currently underway among shared branching facilities to investigate the role they can play in providing affordable financial services, including short term loans, to underserved neighborhoods.

Shared branching facilities offer options to meet the needs of payday borrowers not available through individual credit unions. For example, since a single credit union can participate in several shared branching facilities, many more consumers will have access to affordable credit union services in more neighborhoods. Shared branches provide an excellent distribution channel.

Also, by pooling the resources from the credit unions participating in the shared branch facility, the risk of these short-term loans could be spread among several credit unions.

And finally, shared branches will have better opportunities to offer affordable services to nonmembers due to less regulatory restrictions than individual credit unions.

Using a CUSO to Offer Payday Loan Alternatives

Florida Central Credit Union in Tampa recognizes that credit unions have a unique

role to play in providing financial services to the nation's low to moderate-income persons. When Florida Central decided to form a CUSO in an inner city neighborhood to offer short term loans and check cashing, they believed it was not only the right thing to do – bringing affordable financial services to an underserved area – but also “good sound business”.

Florida Central CU offers these suggestions:

- Amend your bylaws to include low-income communities to allow the credit union to serve as many members of the community as possible.
- Develop a working relationship with a community organization that works inside the neighborhood. These organizations know the residents and can offer sound advice regarding their financial needs. They can assist the credit union in improving their visibility and credibility.
- Form a credit union service organization (CUSO) to provide the identified services. By using a CUSO, the credit union can serve non-members, in addition to members. A CUSO will have more flexibility to offer creative services than current regulations allow. For example, Florida Central Credit Union's CUSO will offer:
 1. Small loans to be repaid in 3, 6, 9 or 12 months – allowing the member

- time to budget for these payments, something a borrower cannot do with two week payday loans;
2. Low cost check cashing to both members and non-members;
 3. Direct deposit or payroll deduction through the credit union;
 4. Affordable money orders;
 5. Bill paying services for utilities, such as phone, water and electricity;
 6. Envelopes and stamps to mail monthly payments;
 7. International wire services so that individuals can wire money on a regular basis to family in, for example, Mexico, South America, or Central America;
 8. A full time consumer credit counselor to assist members with financial problems;
 9. Bus tokens, an important service in this particular neighborhood.

Florida Central believes that this CUSO will be a good source of business for the credit union. As members of the community grow to trust the CUSO, they will be directed to the services of the credit union, and away from the high cost services of payday lenders, check cashers, pawnbrokers and title lenders.

Financial Counseling Outreach Program

Mazuma CU in Kansas City is tackling the growth of payday lenders in their community by bringing financial education into the neighborhoods.

The credit union works closely with community and neighborhood organizations to identify the financial issues facing the local consumers. The credit union then goes into these neighborhoods twice a month and provides seminars related to credit, deposit and sharedraft accounts, budgeting, and any other financial areas that have been identified.

Overdraft Protection

A credit union may establish an overdraft protection program that will cover their members' overdrawn share drafts. Such a program could eliminate the consumers' concerns of high NSF fees for returned checks, another reason consumers cite for using payday lenders. Federally chartered credit unions must, and state chartered credit unions are encouraged to, establish:

- A cap on the total dollar amount of overdrafts the credit union will honor;
- A time limit for a member to either deposit funds or obtain an

approved loan from the credit union to cover each overdraft;

- A dollar limit on the amount of overdrafts the credit union will honor per member.

It will be up to the credit union to determine whether a fee or interest rate will be charged.

Payday Advance Club

A new idea is the “Payday Advance Club”. This program would allow credit union members with direct deposit to join the “club” by paying a nominal entrance fee, for example, \$5 per month or \$25 per year. Membership in the Payday Advance Club would entitle the member to advances on their next deposit at little or no fee.

CREDIT UNIONS TAKE THE INITIATIVE

Financial Education

One of the most important programs CUNA, the state credit union leagues and credit unions are currently promoting is financial education of our nation's youth. We believe that by educating our young people in the area of personal finance they will learn to make sound financial decisions and choose not to use high cost or predatory lenders.

CUNA has partnered with the National Endowment for Financial Education (NEFE) to expand financial education among teens throughout America. Through this partnership CUNA and NEFE provide an educational curriculum and materials to high schools across the country to promote financial literacy.

In addition to providing the necessary materials, credit unions actively participate in the classrooms. During the 1998-99 school year credit unions conducted almost 5,000 presentations reaching almost 120,000 students nationwide.

Currently, only a handful of states have either a mandate for personal finance education or include personal finance concepts in state assessment tests. These numbers are expected to increase over the next few years and credit unions plan to continue providing the

support necessary to meet these educational objectives.

Target Marketing

It really shouldn't be difficult to target your members that are using payday lenders. An essential component of the payday loan is a post-dated share draft in the amount of the funds borrowed, plus the fee. Many credit unions have commented that the payday lenders are the first customers in line on payday to process the stacks of share drafts they have received over the previous two weeks.

These are the members who will gain the most from learning about short term loan products, overdraft protection, credit cards, credit counseling services, shared branch facilities and Micro Loan programs.

Be the First Source for Help

If there is an obvious source that your credit union members will turn to when in financial straits, such as a First Sergeant on their military base, the payroll department of their employer, or the minister of their church, ensure that those sources will send these members directly to you.

Get to know these sources, educate them on the products and services of the credit union and keep up regular contacts to be certain that

the credit union is always their first thought when a member has a financial situation.

A South Carolina airforce base credit union made it a priority to be on a first name basis with all of the First Sergeants. They had regular breakfast meetings with them and kept them up to date on credit union services. They believe this went further to alleviate many of the financial difficulties of the airman than any other credit union program.

Are We Still the “Friendlier” Alternative?

In every consumer survey, credit unions always surpass banks in terms of a friendly atmosphere and great member service. But since we have never had significant competition in this area, could we be getting lax in our member service skills?

The payday lenders have told CUNA that their highest priority in hiring staff is that they be friendly, smiling individuals. They are not concerned with financial skills and do not generally hire from credit unions or banks.

Some credit unions are reevaluating their environments. They are going to the “other side of the line” and experiencing the credit union from the member’s perspective.

- Is the staff friendly to members?

- What types of questions do the loan officers ask?
- Do the credit union's hours of operation accommodate the membership's professional and personal lives?
- How is the credit union's lobby? Formal and staid or casual and colorful? Which does the current membership prefer?

Some credit unions are considering a makeover to meet the expectations of today's membership.