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Credit unions, banks grabbing a share of payday loan dollars

Storefront payday loan centers still dominate the industry. But many banks and credit unions are offering the small, short-term loans, drawn by interest rates as high as 28%.

March 11, 2012 | By Jim Puzzanghera, Los Angeles Times

Reporting from Washington — Payday loans, for years a fixture in poor, working-class neighborhoods, are increasingly being offered by local banks and employee credit unions — triggering concerns by consumer groups that more Americans will be trapped in high-interest loans that could take years to pay off.

More than two dozen regional and community banks now offer versions of these loans, most starting their programs since 2007. The biggest increase, however, has come at credit unions. Nearly 400 now are in the market, attracted by a 2010 change in regulations that boosted the maximum interest rate on payday loans to 28% from 18%.

Conventional payday loans from storefront operations provide workers a two-week advance of as much as $500 on their paychecks for a flat fee or an interest rate that doesn't sound too extreme on the surface.

But many people can't repay the loans when they come due. Instead, they simply roll the loans over from payday to payday, or take out new loans to cover the old ones, piling on additional costs that can result in interest charges of 300% or more over the course of a year.

The move by banks into payday lending — or direct deposit advances, as many of them call it — led about 200 fair-lending, consumer, religious and labor groups to write federal regulators last month and call for prompt action to stop "this inherently dangerous product."

"There are people who wouldn't walk into a payday loan store but think that if a bank is doing it, it must be safe," said Lauren K. Saunders, managing attorney with the National Consumer Law Center. "If you take a look at these products from a consumer protection standpoint, they raise serious red flags."

Banks and credit unions have been searching for new ways to boost revenue in a down economy in which low demand for loans and historically low interest rates have made conventional lending less profitable. And they've seen more of their customers who are scrambling to make ends meet turning to storefront payday lenders.

"At a time when banks are struggling for growth, it's certainly an avenue they're going to look at," said Greg McBride, senior financial analyst at Bankrate.com. But he warned that the loans are risky for financial institutions because the default rates are high.

Jamie Fulmer, spokesman for Advance America, Cash Advance Centers Inc., the nation's largest storefront payday lender, figures that banks and credit unions recognize that payday lenders are "doing something right."

"The services we offer today are now mainstream," Fulmer said. "We are the new norm."

Credit unions and banks said they have jumped into the business because there is a growing need for short-term loans and they can offer them to their customers on better terms than storefront payday lenders.

"Even though it's a higher interest rate than we would normally charge, this is actually a less-expensive alternative," said Steve Weakley, president of the Vons Employees Federal Credit Union in El Monte. It started offering payday loans last year of as much as $750 with a 27.9% interest rate on an annualized basis.

Unlike a typical storefront payday loan, which must be paid back in two weeks, the Vons credit union gives customers at least a month, and up to six months, to repay, he said. The longer term increases the likelihood that the customer will repay and reduces the compounding effect of rollovers or new loans.

"We are not in the business to in any way gouge our members," Weakley said.

Elmer Garrido had heard horror stories about the high cost of storefront payday loans. So when the Redwood City resident was desperate for $450 to repair his 2003 Dodge Intrepid, he turned to Community Trust credit union in San Francisco.

"I didn't want to pay so much," said Garrido, 30, who needs a car for his landscaping job. "The credit union gave me an opportunity to get the loan and to fix my car."

Garrido got a $500 loan at an 18% annualized interest rate that he can pay off over 10 months. The credit union is part of the Payday Plus SF program started in 2009 by the city of San Francisco to provide alternatives to storefront payday lenders.

"We have more payday lenders and check cashers in San Francisco than we have Starbucks and McDonald's combined," San Francisco Treasurer José Cisneros said. "They really are preying on people who are least able to afford their exorbitant rates and fees."

Consumer advocates cautioned that any short-term, high-interest-rate loan is a bad deal for the customer.

"If it is a high-interest-rate loan that's getting rolled over without having any reduction in principal, then you're really starting to put people in a trap," said Nick Bourke, director of the Safe Small Dollar Loans Research Project at the Pew Charitable Trusts.

The Consumer Financial Protection Bureau has launched a broad review of payday lending from any source — storefront operations, banks and credit unions.

"Maybe you would never dream of paying an annual percentage rate of 400% on a credit card or any other type of loan, but you might do it for a payday loan," Richard Cordray, the agency's director, said at a recent hearing. "When you're desperate, the terms of the loan seem to matter a lot less."

The Office of the Comptroller of the Currency, which regulates national banks, is considering new guidelines on payday loans, such as making sure repayments taken directly from customers' accounts don't lead to overdraft fees.

And the National Credit Union Administration has placed restrictions on payday loans from Community Trust and other institutions it regulates, such as capping the annual percentage rate, giving customers at least a month to repay and not allowing them to roll over the loans.

The number of federally chartered credit unions offering payday loans jumped to 390 from 244 last year. They had $18.7 million in payday loans outstanding at the end of December, up from $8.9 million at the end of March.

"There's a real need out there," said Debbie Matz, chairwoman of the federal credit union regulator.

There is no overall data on bank payday loans. But storefront payday lenders still dominate the market, with 20,600 locations making $38.5 billion in loans each year, according to the Community Financial Services Assn. of America, an industry trade group.

Storefront lenders offer two-week advances. Although the average loan is $345, rollovers and new loans mean the typical payday borrower takes out about $2,000 in loans a year. The fee of $15 to $20 for every $100 borrowed is, in effect, an interest rate, but the two-week term means the annual percentage rate amounts to 300% to 600%.

Banks and credit unions can easily undercut the storefront operations.

Wells Fargo Bank, which first dipped into the market in 1994, offers Direct Deposit Advance to customers whose paychecks are wired directly to their bank accounts. The bank charges $7.50 for every $100 advanced, with a $500 limit. The loan must be repaid in 35 days and can't be rolled over, but a customer can take out new loans for six straight months.

"It is still without a doubt an expensive form of credit," bank spokeswoman Richele Messick said.

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