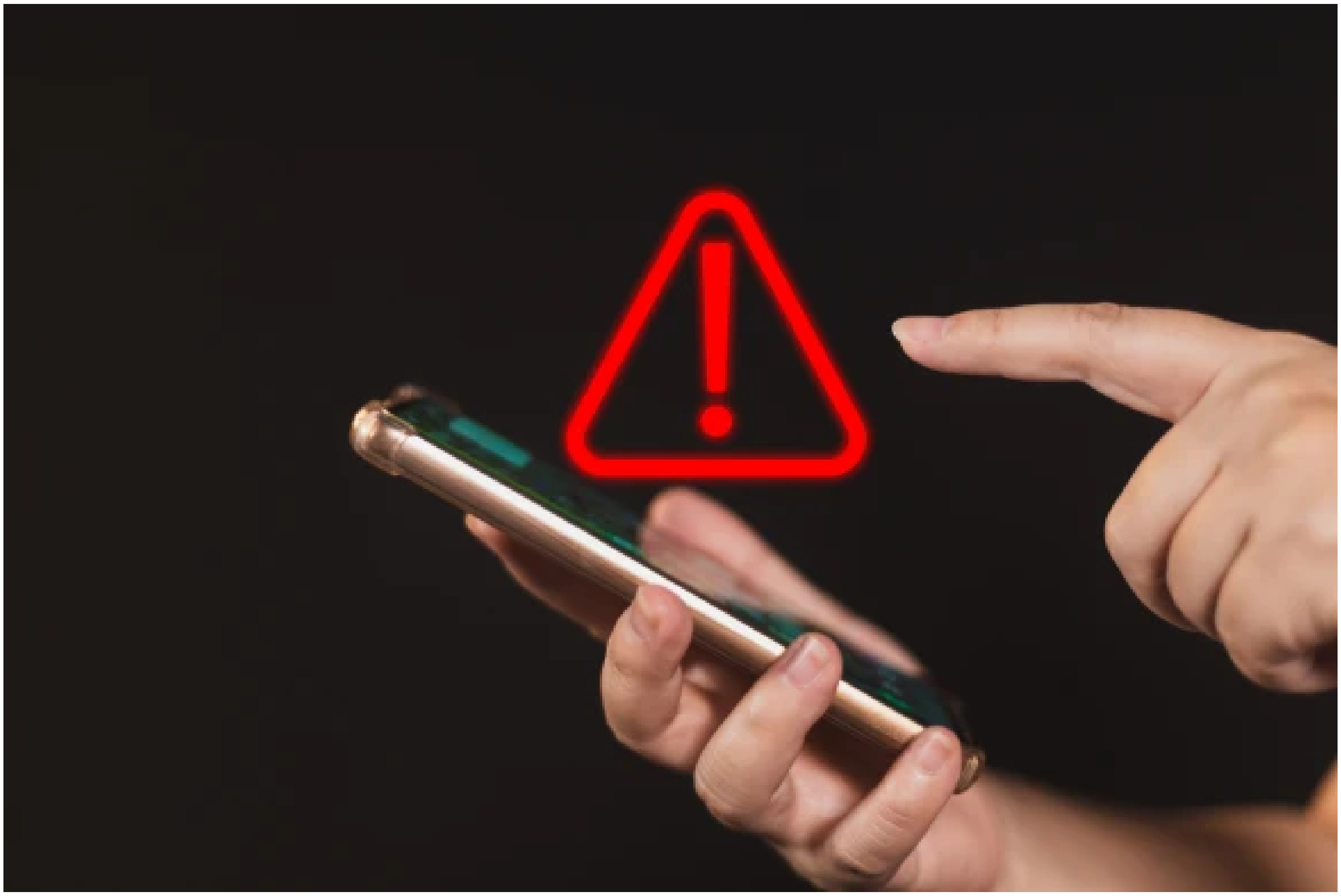
REGULATION AND COMPLIANCE

BankThink States must protect consumers from high-cost fintech cash advances

By Lauren Saunders Yasmin Farahi December 20, 2023, 10:00 a.m. EST 4 Min Read



State regulators shouldn't allow fintech-enabled earned wage access programs to become the new face of predatory lending, write Lauren Saunders and Yasmin Farahi. *ruiiruii/eakgrungenerd - stock.adobe.com*

States are starting to grapple with purportedly new categories of small-dollar loans: earned wage advances and other types of fintech cash advances. Their approach will determine if workers and consumers will be protected from spiraling fees that drain low wages or if a new kind of payday loan will be allowed to operate outside of laws against high-cost lending.

Earned wage advances (EWAs) are advances on pay, repaid on payday from payroll deduction or another method, with the loan amount tied to wages accrued but not yet due. Employers may cover the cost as a benefit, or workers may pay fees. A fake form of EWA has no connection to payroll, is repaid by debiting bank accounts and hides fees in purportedly voluntary "tips."

California data on over 5 million total transactions from several leading companies show that both models offer little credit, $40 to $100 for about 10 days, at alarming average annual percentage rates of over 330%. Tip-based companies succeed in pushing consumers to "tip" 73% of the time. Both models result in reborrowing even more chronic than traditional payday loans, with an average of 36 advances a year — more than one advance every biweekly pay period. These are clear signs of a debt trap.

Providers claim that these advances are not loans and that costs are just like an "ATM fee" for accessing "your own money" — a claim eerily similar to arguments payday lenders used decades ago to exempt their "check cashing fees" on deferred check presentments from usury laws.

This year, Missouri and Nevada bought those arguments, exempting EWAs from lending laws with no limits on costs and no meaningful consumer protections. The bills they passed were based on model legislation from the American Legislative Exchange Council (ALEC). The states define "earned wages" so broadly — based on self-certification and "reasonable" verification — that traditional payday lenders could restyle themselves to fit the definition. Providers must offer a free option, but it can be slow and inconvenient for borrowers who were sold on fast cash. "Tips" must be voluntary, but the laws do not restrict a myriad of design, behavioral and psychological techniques that California found "make tips almost as certain as required fees."

California, Connecticut and Maryland have charted a different course, recognizing that EWAs from third parties with costs can be loans. Connecticut is the leader: The state has clarified coverage in statute and the Department of Banking has put out clear guidance that the state's lending laws, including rate caps, apply. California, with generally strong consumer protection laws, is on a similar course, though it has proposed a four-year transition period where only registration would be required. Maryland has issued guidance that assesses factors that all point to the conclusion that third-party EWAs that are not provided directly by employers are loans. The state warns consumers that costs can equate to 300% APR and are "possibly illegal under Maryland law."

PAYMENTS

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By Kate Fitzgerald

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It is not hard to see a pattern in these two camps. Missouri and Nevada have unfettered payday loan markets, no interest rate caps on short-term loans to evade and weak consumer protection laws generally.

The trio of states meaningfully regulating EWA as credit all have strong anti-predatory lending laws and a track record of defending their laws against evasion. Their model should be followed in all states, but particularly by states that have strong lending laws and want to prevent evasion by new, unaffordable forms of fintech cash advances.

Our two organizations recently issued state recommendations for regulating earned wage advances. Our top recommendation, especially for states with strong lending laws, is to follow the Connecticut approach: Enforce and, if necessary, clarify and strengthen credit laws to cover fintech cash advances, without creating a new category specifically for them.

We recognize that states plagued by payday loans, and without effective lending laws to enforce, may be tempted to embrace EWA as an alternative that appears less pernicious. In that situation, the second-best model is not Missouri and Nevada, but real cost limits and protections from the worst aspects of the EWA business model. At most, special treatment should be given only to employer-integrated EWAs repaid directly from the employer, not fake direct-to-consumer models that debit bank accounts. Total cost, including all payments however labeled, should be at most a few dollars per month or a couple of dollars per pay period.

Limiting costs to workers living paycheck to paycheck is critical, as every dollar counts. EWA companies tout the benefits to employers "At zero cost to you" (the employer). But they usually expect low-wage workers, disproportionately in Black and brown communities, to cover those costs.

States have a choice: They can adopt real protections, or they can enshrine a system where workers pay to be paid and fintech cash advances are the new payday loan.

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