

Issue Briefs

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Family Financial Education



Financial Service Alternatives to Traditional Accounts

What is an "alternative" financial service?

Many services are offered outside of federally-insured or regulated financial institutions.

Some examples:

- check-cashers
- money transmission/ remittance
- car title lenders
- payday loans
- pawnshops
- rent-to-own stores

Most are sold in storefronts although the Internet and mobile phones are a growing delivery mechanism.

It is estimated that non-traditional, non-bank providers:

- provide more than \$320 billion in services annually.
- operate 13,000 nonbank financial services companies nationwide.
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Check Cashers

Check cashers simply cash checks. Some are retail outlets focused on just money transactions; others are multi-line locations. Typically providers charge 1 to 4 percent of the face value of the check. Payroll checks and federal benefits checks are typical (although federal benefits will no longer be sent as paper checks by 2013). Consumers use these outlets primarily for the convenience of location and hours.

Prepaid Cards

Stored value (or "prepaid") cards are a small but growing replacement for cash and checks. So called "open loop" cards can be redeemed at any retailer that accepts debit cards. These cards look like bank-linked cards and are issued with the Visa or MasterCard logo. Issuers can be banks or nonbanks. Cards have a wide variation in fees for set up, re-loading and use. Payroll cards are often used by employers as a replacement for direct deposit of paychecks for employees without accounts.

Cards provide the ability to pay for transactions and use an ATM, as well as online or phone payments. Some consumers find the simplicity and fees attractive, especially if they have accumulated fees on checking accounts in the past (low balance fees, NSF, etc).

Cards may charge high fees, but relative to the alternative may not be more costly. Some consumers prefer stored value cards as a way to control spending.

Payday Lending

Payday loans are short-term loans extended to consumers who have a checking account and can prove that they are employed. A check is postdated to the borrower's next payday to the lender.

Loans tend to be small and charge fees per payment period—typically a pay cycle (2 or 4 weeks). A loan of \$400 with a \$40 fee may

suggest an annual percentage rate (APR) of over 400 percent. Most consumers will not roll over a loan for a full year, but may roll a loan 4 to 6 times, resulting in high fees regardless.

Consumers using these loans tend to be strapped for cash and if not for the payday loan may default on another loan, miss a utility or rent payment or bounce checks. These alternatives are also high cost.

In 2010 Wisconsin passed a law to regulate payday lending that goes into effect Dec. 1, 2010. The bill as passed allowed payday loans limited to \$1,500 or 35 percent of the applicant's monthly income, whichever is less. Borrowers can roll the loans over only once and the use of multiple lenders will be tracked. Also new lenders are prohibited within 1,500 feet of each other or 150 feet of certain residential zones.

Small Dollar Loans

In 2008, the FDIC piloted a small-dollar loan program with 28 firms—including 2 in Wisconsin (Benton State Bank, Benton, WI & Mitchell Bank, Milwaukee, WI).

The goal is to encourage institutions to experiment with providing safe and profitable small-dollar loans per FDIC's guidelines (see [PR-52-2007: FDIC Issues Final Guidelines on Affordable Small-Dollar Loans](#))

Key features

- Loan amounts of up to \$1,000;
- Amortization periods longer than a single pay cycle, up to 36 months;
- Annual percentage rates (APR) below 36 percent;
- No prepayment penalties;
- Limit fees.

The pilot program is ongoing but promises some innovative approaches to meet consumer needs.

Pawn lending

Pawn lending is one of the original alternative financial services. These are short-term loans where the lender takes physical possession of the item securing the loan. The pawn shop can sell the item if the borrower does not pay back the loan and fees. Fees vary, but typically a borrower receives about half of the resale value of the item. Most borrowers fail to repay the loan and items are sold at retail values—much like a resale shop. Pawn lending has declined in recent years as payday loans and alternatives have grown.

Auto title lending

Title lenders make loans that are secured by car titles. This is a growing market, but also under increased scrutiny. In 2010, Wisconsin Governor Doyle altered/vetoed a law regulating the industry which effectively banned auto title loans in the state as of December 2010.

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