Costly Bank Payday Loans Criticized in Report

By Jessica Silver-Greenberg
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Some of the nation's largest banks continue to offer payday loans, pitched as advances on direct-deposit paychecks, despite growing regulatory scrutiny and mounting criticism about the short-term, high-cost loans.

The findings, outlined in a report by the Center for Responsible Lending to be released on Thursday, provide the latest glimpse into the methods that banks are aggressively using to earn new revenue.

According to bank analysts, banks are looking to recoup the billions in lost income from a spate of regulations restricting fees on debit and credit cards.

Across the nation, roughly six banks, including Wells Fargo and U.S. Bank, make the loans.

The loans can prove expensive, the report shows, typically costing $10 for every $100 borrowed. They are often used by low-income customers, said the center, a nonprofit group that studies consumer lending issues.

At first glance, the loans do not seem like a typical payday loan offered by storefront lenders. Instead, banks typically allow a customer to borrow the money against a checking account. When a loan payment is due, the bank automatically withdraws the cash — the amount of the loan plus the origination fee.

The banks have been charging interest rates that average 225 to 300 percent, according to the report. Problems arise when there is not enough money in the account to cover the payment and the total is withdrawn regardless of whether there is sufficient cash in the account.

For consumers, this can lead to a cascade of overdraft charges and fees for insufficient funds, according to the report.

Customers who opt for a payday loan are about two times as likely to be hit with an overdraft fee, according to the report.

Those fees can be particularly devastating for customers with limited incomes, the report said. According to researchers at the center, roughly 25 percent of all customers who take out bank payday loans are Social Security recipients. One customer cited in the report paid $162 in interest and $57 in overdraft fees after taking out a loan.

Banks, however, say that they are catering to consumer demand.

“It’s a service that we believe is an important option for our customers and is designed as an emergency option,” said Richele J. Messick, a spokeswoman for Wells Fargo. She added that the bank was “very upfront and transparent with customers that this is an expensive form of credit and is not intended to solve long-term financial needs.”

U.S. Bank could not be reached for comment.

The peril for older consumers is heightened because of recent changes in the way that government benefits are distributed, the report says. Starting this month, government benefits, including Social Security payments, have been deposited directly into checking or savings accounts.

Social Security recipients who take out a payday loan, the report states, could find their benefits eroded when those dollars are used to satisfy overdraft and other fees associated with the payday loans.

Regulators have issued warnings about abusive payday loan practices.

Last May, the Federal Deposit Insurance Corporation said the agency was “deeply concerned” about payday lending.

The Office of the Comptroller of the Currency, which oversees the nation’s largest banks, said in June 2011 that the loans raised “operational and credit risks and supervisory concerns.”

The Consumer Financial Protection Bureau, a new federal agency, said it was examining whether banks ran afoul of consumer protection laws in the marketing of these products. So far, though, the products are widely available.