What to Consider When Considering an Employee Loan Program

Employers are becoming more aware of the financial struggles their employees are experiencing. Roughly 25 million employees a year use payday and car title loans, paying triple-digit interest rates.

>> **One of the biggest reasons people are willing to pay such exorbitant rates for a loan is that they do not qualify for "traditional" loans from banks or credit unions—or even credit cards—because of their lack of a credit score or poor credit.**

A first step is to recognize that an employer can play a significant and positive role in helping employees improve their finances. Research continues to show that employees perform better when their financial stress is lower. Some employers are addressing this need by offering alternative lending options as part of an employee benefit program. The employee benefit channel can be an efficient way to reach consumers in need, and provide credit to those employees at a fair and reasonable price that is still sustainable for the lender.

However, all employee loan programs are not equal.

Here is a checklist of items you should explore when it comes to employee loan programs:

Is a credit score required?

The consumers most vulnerable to predatory lending and most likely to need an alternative to payday lending are consumers with no credit score, or extremely poor credit. There are 11 million Americans considered "credit invisible" because they lack sufficient credit history to qualify for traditional forms of credit, and another 15 million who have such damaged credit that they struggle to qualify for traditional credit. A program that turns employees down because of their lack of a credit score or poor credit is not helping those employees who need the help the most.

If credit scores are used, you may not be solving the problem for the most vulnerable in your workforce.

Who is actually lending the money?

The most vulnerable employees in need of an alternative lending solution are usually excluded from the traditional banking and credit union world because of poor credit or limited financial history. Their financial lives depend largely on state-licensed consumer finance lenders—payday lenders, car title lenders, and consumer installment lenders.

These consumer finance companies do not take deposits or offer savings accounts—they simply finance consumer loans. State consumer finance companies generally operate under rules and regulations that are significantly less stringent and rigorous than banks or credit unions—and some states don't require any licensing at all. Other states require a simple application fee of a few thousand dollars and a security bond. Bottom line: Who the lender is does matter.

If the loans are not made by a credible bank or credit union, you may be reinforcing a cultural dependence on consumer finance lending at high rates and limited consumer protections.

Are all employees eligible for the same loan terms?

Loan rates can be a "bait and switch" situation. If your employee loan program offers better loan terms to employees with high personal credit scores, and more expensive terms to employees with poor personal credit scores, you are being least helpful to the employees who need help the most.

If the loan program charges higher rates to the employees who need help the most, you may be benefitting your highest compensated employees at the expense of your lowest compensated employees, leaving them to continue to struggle.

Is the program designed to get your employees out of debt? Or keep them in debt?

One benefit of an employee loan program is that it can help an employee escape the cycle of debt caused by predatory lenders by providing an affordable alternative that can be paid off in a reasonable time at a reasonable rate. Some programs will allow employees to extend their small dollar loan payments to two or three years—on loans as small as $500-$1,000. This allows them to disclose a "smaller" interest rate, but actually collect more money from the employee because they are charging the interest for a longer period of time. Some programs also allow for refinancing of the loan, which continues the cycle of debt.

If an employee loan program does not offer a fair, clear, and low-cost loan that is repayable over a short time without keeping people in a debt cycle, it is not a credible financial wellness program.

Is the loan affordable?

An employee loan should be helpful to your employees' financial situations and leave them enough money in their paychecks to cover their expenses. Some loan programs do not have sufficient underwriting or caps on loans, which means too much money is deducted from their paychecks. Unfortunately, this leads to employees either needing to borrow again or borrow from a high-cost source.

If an employee loan program deducts too much from a paycheck, it will likely cause an employee to borrow more money or borrow from high-cost sources.

Are the loan terms clear and easy to understand?

Loan terms should be simple, transparent, and easy to understand. Too many variables and complex terms can cause your employees to pay far more than they should for the financial help they need. Regulatory agencies make it clear that consumer loans should be disclosed as an APR (Annual Percentage Rate), which includes application fees, interest, and any other fees. Clear terms of the loan such as how much comes out of a paycheck and the length of the loan are also critical for employees.

If the loan is not discussed with an APR (all-inclusive fees and interest), it won't allow employees to make apples-to-apples comparisons and understand their loan.

The Coalition for Safe Loan Alternatives is here to help you find a financial support program that is safe and affordable.

Check out cfsla.org for presentations on safe and affordable products.

COALITION FOR SAFE LOAN ALTERNATIVES

Employee Loan Program Comparison Chart

	Company 1	Company 2	Company 3
Is a credit score required?			
Who is actually lending the money?			
Are all employees eligible for the same loan terms?			
Is your program designed to get your employees out of debt? Or keep them in debt?			
Is the loan affordable?			
Are the loan terms clear and easy to understand?			