

A blow to 'pay stub' loans

HSBC to quit what advocates say is a practice preying on poor

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After protests from consumer advocacy groups and legislators, HSBC Finance Corp. will discontinue its so-called "pay-stub" and "holiday" loans, which have been decried as usurious and predatory.

The loans, known in the industry as pre-file and pre-season products, are issued through tax preparation sites such as H&R Block and Jackson Hewitt, and carry double- and triple-digit annual percentage rates. Available as early as November, they are made based on people's projected tax refund and earned income tax credits, using their pay stubs.

"We're just going through a strategic review of all of our products, and we made the decision to get out of these and focus on some other parts of the business going forward," said HSBC spokeswoman Diane Bergan.

Oftentimes, taxpayers who take out pay-stub and holiday loans return to the tax preparer to get their taxes done during tax season. Then, borrowers can repay their pay stub and holiday loans by taking out a tax refund anticipation loan, or RAL.

RALs are secured loans, made against the borrower's expected tax refund and earned income tax credit. They, too, are high-cost, with annual percentage rates of 36 percent to 500 percent, and are favored by low-income people in need of fast cash.

The New York State Division of Human Rights — which is charged with enforcing the state's anti-discrimination law — has launched an investigation into potentially discriminatory practices by tax preparation companies through RALs. The division contends that companies such as H&R Block, Jackson Hewitt and Liberty Tax Service, which partner with banks including HSBC, target low-income individuals, primarily in communities of color, and military families for the loans.

The actual amount people pay in fees — \$250, on average — isn't what troubles consumer advocates. "It's when you start looking at the cumulative effect that it becomes overwhelming," said Joan Roby-Davison, executive director of Group 14621.

The 14621 ZIP code, one of the poorest in the city, was among the hardest hit in the state, in terms of the amount paid by its residents in RAL fees: \$3.5 million over the last four years, said the Neighborhood Economic Development Advocacy Project, which analyzed IRS data from that period.

In total, RALs cost Monroe County taxpayers more than \$29 million between 2002 and 2005, the New York City-based neighborhood project found.

A *Democrat and Chronicle* database, created with advocacy project figures, shows that residents in most area ZIP codes paid something in RAL fees. But taxpayers in Mendon spent only \$5,500 in the last four years, while those in 14621 and 14609, in northeast Rochester, and 14611, in western Rochester, collectively spent \$8.8 million.

Search the Database:

Search by ZIP code to find how much was spent on fees for tax refund anticipation loans in your neighborhood.

What's at stake

The financial well-being of low-income taxpayers. Refund anticipation loans are financial products provided by third-party banks that are available through tax preparation offices. While tax preparers maintain that the product is useful and appropriately marketed, consumer advocates contend it is a form of predatory lending that siphons money from low-income neighborhoods. HSBC recently announced it was discontinuing so-called pay stub and holiday loans.

Roby-Davison described HSBC's announcement about its discontinuance of pay-stub and holiday loans as "a partial victory" and a "step in the right direction." The changes are to take effect in the upcoming tax season.

Sarah Ludwig, executive director of NEDAP, said: "We are heartened to see HSBC acknowledge that pay stub loans are a harmful product that should be kept off the market. We hope this is the first step in HSBC's dismantling its overall RALs business. ..."

Bergan said that discontinuing the pre-file and pre-season loans was "part of a broader business decision. ... We are going to discuss RALs with our business partners going forward.

"But I have no additional information on what may change with those.

"The advocates, we know, have raised sensitivity about some of these products," she added, "but we feel our products are a fair choice, and I emphasize the word choice. There's a cost to these products, and we want our customers to know that."

The RALs work in the following way: The tax preparer sets up a temporary account for the borrower at a partner bank. After the IRS deposits the refund into the account, the bank deducts service and loan fees, and then issues the difference to the tax preparer.

Borrowers typically pay three fees: a federal and state tax form preparation fee; an electronic filing fee; and a finance charge assessed on a sliding scale based on the expected refund. Interest rates for RALs are not subject to state usury caps — in New York it's 25 percent — because the banks that offer the advances are federally regulated.

"HSBC has been able to circumvent state usury laws that protect consumers because its regulator, the Office of the Comptroller of the Currency, has effectively exempted national banks like HSBC from complying with state consumer protection laws," said Marva Williams, senior vice president of the Chicago-based Woodstock Institute. "We call on the comptroller to ensure that other national banks also stop making pay stub and holiday loans."

With HSBC — the largest issuer of RALs in the country, according to Ludwig — leaving the market, JPMorgan Chase and Santa Barbara Bank & Trust are now the country's largest issuers of pay stub loans.

HSBC will instead concentrate on tax refund anticipation checks, which are cut for the customer, for a fee, after the IRS has processed the refund; and pre-paid cards, onto which customers can put their refunds for use like debit cards.

Tax preparers have argued that RALs and related products fill a need, particularly for people who don't have a bank account and therefore can't have their refunds deposited directly by the IRS. And for millions of low-income families, RALs are quick money to pay for food and shelter, and even the cost of preparing their tax forms.

Consumer advocates encourage these taxpayers to seek free tax preparation assistance. The amount of time it can take to get a tax refund the traditional way — through the mail — may be as little as two weeks. "We need to keep doing that education," said Roby-Davison.

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