



PREDATORY LENDING ALERT

*For community groups and advocates
December 2006*

Tax Preparers and Banks Roll Out High Cost “Pay Stub/Holiday” Loans

The Neighborhood Economic Development Advocacy Project (NEDAP) is reaching out to community groups to alert them to a new predatory loan product known as “pay stub” or “holiday” loans, which are targeted at working people strapped for cash.

***** ACTION NEEDED: Groups are encouraged to inform their members and constituents about these predatory loans, and provide information on sound, affordable alternatives (see below).**

Signs have cropped up in subway stations and in low income communities for “Instant Money Now” and “HELP-Holiday Express Loan Program” loans – designed to lure low income New Yorkers into tax prep offices before tax season even begins. Companies like Jackson Hewitt and H&R Block are aggressively marketing pay stub/holiday loans, promising people fast cash and an early jump on their tax refunds. These loans, however, are risky and extremely high-cost to the borrower.

How do Pay Stub Loans Work?

Pay stub/holiday loans are available as early as November. They are made based on a person’s projected tax refund and Earned Income Tax Credits (EITC), using his or her pay stub. The loans are intended to hook taxpayers into coming back to get their taxes done during tax season. At that time, it is generally expected that borrowers will repay their pay stub/holiday loan by taking out a second high-cost loan, known as a tax refund anticipation loan (RAL). Unlike pay stub/holiday loans, RALs are secured loans, made against the borrower’s expected tax refund and EITC.

What are the Costs and Risks of these Loans?

- Pay stub loans can set in motion a cycle of expensive debt for borrowers, sometimes even before the New Year has begun.
- Most pay stub loans carry annual percentage rates (APRs) in the triple-digits.
- Pay stub loans are made without regard to the borrower’s actual ability to repay the loan.
- Pay stub loans often include additional, sometimes hidden, fees. For instance, one lender requires borrowers to receive their pay stub loan on a debit card, in turn requiring them to pay fees to load the money onto the card and usage fees.
- One lender begins to make collection calls on pay stub loans in the middle of January, weeks before many borrowers have even received their W-2 from their employer. Borrowers may be pressured to return to the tax prep office and repay the loan before they even have the documentation necessary to get their taxes done.

How do Refund Anticipation Loans Harm Low-Income Communities?

Nationwide, RALs have stripped billions of dollars from low income communities. A report issued by NEDAP found that low income taxpayers in New York City paid nearly \$71 million in tax preparation and RALs fees in 2004, and that nearly 1 in 4 New Yorkers claiming the EITC borrowed a RAL in 2004. In New York City, the neighborhoods with the highest percentages of RALs include Hunts Point and Morrisania in the Bronx, Brownsville and Ocean Hill in Central Brooklyn, and Central Harlem in Manhattan – some of the lowest income communities in the city.

Many advocates consider industry RALs predatory and exploitative of the working poor, and think RALs and pay stub/holiday loans should be prohibited.

Who Profits from Refund Anticipation Loans?

Although tax preparers are the public face of pay stub RALs, it is actually a small handful of banks – HSBC, JPMorgan Chase, Santa Barbara Bank & Trust, and Republic Bank & Trust – that makes virtually all pay stub loans and RALs. The banks making pay stub RALs and the tax preparation businesses marketing them are expected to generate huge profits from pay stub loans. HSBC, the country's largest RALs issuer, made \$16.1 billion in RAL loans in the first nine months of 2006.

Because most pay stub loans will be refinanced through RALs, NEDAP anticipates that an increase in pay stub loans will lead to an increase in the total number of RALs issued during tax season.

Some major industry players have publicly acknowledged the abusive nature of pay stub loans. According to Mark Ernst, chief executive of H&R Block, the nation's largest tax preparer, "The association of these high-cost pay-stub loans with tax preparation generally is not good for consumers..." One bank recently left the pay stub loan business, suggesting that it would not offer these "legally questionable" products, "especially since most Pay Stub loan customers receive their refunds through the EITC."

What Alternatives are Available to Taxpayers?

Low income taxpayers can receive free tax prep assistance at a number of sites throughout New York City and State, including at Volunteer Income Tax Assistance (VITA) sites. Many credit unions have special savings programs designed to help prepare people for holiday season expenses and loans that are much more affordable than pay stub loans and conventional RALs.

If you would like a list of community development credit unions, free tax prep sites, or if you are affiliated with a community-based organization and would like to learn more about advocacy efforts to curb pay stub lending and abusive RALs, please call NEDAP at (212) 680-5100.