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FinTech Firms Can and Should Facilitate Postal Lending

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Abstract

For too many Americans, this is their financial reality:

- **Half of Americans** have subprime credit scores.
- 57% have **less than $1,000** in their savings account.
- Nearly 8 out of 10 **live paycheck to paycheck.**

And the access to traditional banking and credit vehicles is diminishing:

- **The US has seen a 30% decline** in bank branches across the country since 1990.
- 27% of US households **don't have regular access to a bank.**
- **7% of Americans are completely unbanked.**

In practice, this means that 165 million Americans are living their daily lives on the edge of financial disaster. Something as mundane as car trouble can be financially catastrophic if that means reduced hours at work or even job loss. Without the savings or credit to address an unexpected car, medical, or family expense, the American subprime consumer is shunted into an unfair and informal economy of bank overdraft fees, high interest credit cards and, most dangerous, predatory payday lending.

Payday loans are truly horrific: short term (2 weeks), small dollar ($500), at an average of 400% APR. Payday loans are debt traps by design that prey on the financially vulnerable: particularly the low-income, minorities, and the financially illiterate.

The list of payday predations is endless but here are three stats that paint the picture…

· **Only 14% of payday loan borrowers** can actually afford their loans. Which means…
· 4 out of 5 payday loans are "rolled over"—or extended for another short term **at the cost of another round of fees and interest.**
· The average payday borrower takes out 10 loans per year and **spends 199 days of the year in debt**.

The current financial climate in the United States has created a scenario that is prime for modern FinTech firms to facilitate "postal banking"—thus reducing banking deserts and potentially eliminating the insidious payday loan industry.

Kirsten Gillibrand's proposal to establish post offices as banking centers should be the catalyst for the economic change of millions of struggling Americans. A strategic partnership with a FinTech organization could establish banking accessibility that hasn't been seen in decades.

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Introduction

As of this year, almost 60 percent of Americans have less than $1,000 in their savings account[1]. While some of those Americans are living paycheck to paycheck, risking costly bank overdraft fees, others are living without a bank whatsoever. Communities without a single bank have grown in number and continue to spread across the country, affecting millions, making it nearly impossible to access basic financial products like checking accounts or small business loans. But even those with banks find themselves searching elsewhere for their financial needs, as they are unable to secure lines of credit from their bank due to poor credit scores or high-risk banking behavior.

Many Americans now turn to banking alternatives for their financial solutions. They take out expensive payday loans, cash their hard-earned paychecks at cashier cashing locations, and now spend up to $1,200 a year accessing their own hard earned money.[2] Over the last twenty years there has been a contentious debate over the quality of these alternative financial services so many Americans are using, as well as their effect on the surrounding communities. Some states have already introduced state-mandated regulations on alternative providers to ensure their products are not taking advantage of their customers, but many states let them run free, able to charge what they choose, which creates an industry where a select few can grow rich off of susceptible Americans with no other options.

But in the wake of this crisis, a new opportunity has presented itself. The advancement and expansion of financial technology firms has opened the door for multiple alternatives to traditional banking. For years, a high percentage of Americans have banked online, through their personal bank online portals, third party savings account smartphone applications, credit card apps, student loan consolidation vendors, and many more. Data has shown that millennials, through their ubiquitous access to technology, have already become better at saving than previous generations, proving that more control, and options, yield positive personal financial habits.

With such significant technological growth and advancement, it should only be a matter of time until the possibilities result in legislative change for the good of underserved Americans. Already we have a senator who has proposed a banking alternative that could revolutionize the monetary dilemmas of unbanked and underbanked citizens, so many of which have been all but forced to choose expensive vendors for needed debt reliefs. The future is poised for a new approach to banking for those who need it most.

Underserved U.S. households

Despite a strong economy and available online services, the percentage of Americans with little or no access to a bank account has stayed roughly the same since 2009.

% of U.S. households

*Underbanked households have at least one bank account but still use alternative financial services. Unbanked households have no bank accounts.

Source: 2015 FDIC survey @latimesgraphics

The number of banks is declining. In fact, The United States has seen a 30 percent decline in bank branches across the country since 1990.[3] In the wake of the financial crisis of 2008, the country saw a wave of over 5,000 branches close[4], with our nation's banks collapsing under the weight of unpaid subprime home mortgages. By 2010, more bank branches closed than opened - a feat not seen in over 15 years[5], and this trend is only expected to continue.

The steady decline of bank branch locations is a result of a handful of reasons, none of which is entirely to blame. Bank regulations introduced in the early nineties, such as regulating overdraft fees, a major source of branch income, increased the cost of maintaining overhead. Megabanks began merging, closing their least profitable branches and opening few branches in their place, which typically found homes in affluent neighborhoods. Smaller banks began to disappear, with nobody moving in to take their place.

With the decline of banks, what was left in their place were financially dry communities, accurately coined "bank deserts" - neighborhoods with no physical bank branch within ten miles of the center of the community.[4] These bank deserts can be found across the entire country, but the bulk of them are found in the southwest, in low-income and minority communities.

The effect of a branch closing can be detrimental to the economic health of the community, regardless of the number of bank branches remaining. A study found that with the closure of just one bank branch, the number of small business loans made in the community can fall by 13 percent or more for the following eight years after the

closure.[4] But not only do bank closures have a residual effect on businesses in the community; the complete absence of banks can drive up the cost of small business loans. A study found that the interest rates for small business loans increase as the distance between the firm and the bank grows, making bank deserts essentially a more expensive area to open a business.[4]

While the decline of bank branches across the country, and the subsequent creation of bank deserts, has caused many with limited to no access to a banking institution, the problem doesn't end there. There are still many Americans within proximity of a bank branch that do not have a bank account, rendering themselves unbanked. While the percentage of Americans without banks has slightly declined (unbanked Americans fell to 7 percent in 2015 from 7.7 percent in 2013[11]), this is still 9 million Americans without basic banking services at their disposal. The most common reason unbanked Americans cited for their lack of a bank account is not having enough cash to open and maintain a bank account at a mainstream branch.[12] There also continues to be a perception of mainstream banks as “exclusive”, which is only furthering an underlying issue of socio economic disenfranchisement.[10] Compared to other developed nations, the United States lags behind countries such as Canada, Germany, and Spain. (see chart)

CHART: the United States lags behind other developed nations. The percentage of Americans who are completely unbanked is 7 percent. For comparison, a 2014 World Bank report shows that the percentage of Canadians without a financial institution account is less than 1 percent; Germans, less than 2 percent; and Spaniards, less than 3 percent. (source-https://www.ozy.com/acumen/one-out-of-every-4-americans-is-underbanked/87796)

And even despite this slight downward trend in unbanked Americans, the number of Americans labeled “underbanked” has seen little change since the FDIC began tracking the financial health of the country in 2009. The FDIC reported a .1 percent drop in underbanked Americans in 2015 compared to 2013.[11]

Millions of Americans with bank accounts are still not able to fully utilize their banks financial services. According to a 2015 FDIC survey, 20 percent of US households are considered underbanked, with the majority being young, poor, uneducated, and black and latino.[10] That’s 81.6 million Americans without access to highly valuable financial services, such as auto loans, home loans, and small business loans. The FDIC believes that unbanked households are increasingly likely to view banks as uninterested in serving their financial needs, with only 17 percent of unbanked American households with that perception expected to open a bank account within the next 12 months.[10] The Center for Financial Services Innovation - a nonprofit think tank in Chicago - estimates that underbanked Americans spend about $8 billion a year in fees for check-cashing services and payday loans, which can be perceived as the price for being poor.[10] The unbanked and the underbanked alike are using their hard-earned money to manage their own financial being, allocating funds that could have been used to build wealth or pay for unexpected expenses towards alternative financial services, creating patterns of cyclical debt that are near impossible to overcome.

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Estimated fees and interest paid in 2017 for services most likely to be used by unbanked and underbanked households
Subprime auto loans and leases
$49.3 billion
Bank overdrafts
$24.9 billion
Pawn and payday loans
$13.4 billion
Check cashing, money transfers, bill pay, money orders, prepaid cards
$12.1 billion
Installment and auto-title loans
$11.4 billion
Subprime and secured credit cards
$8.7 billion
Source: Center for Financial Services Innovation
@latimesgraphics

Alternative Financial Solutions and Their Negative Effect on Financial Well-Being

With the disappearance of bank branches came the appearance of alternative finance companies. The most prominent were Payday lenders who took advantage of bank deserts as well as low-income communities. These lenders quickly moved in and began offering quick cash at a high cost. The growth of the payday lender over the last twenty years has had a tidal wave effect on the country's poor. Payday lenders have grown astronomically in low-income communities, preying on minorities and offering financial products that have already drowned millions of Americans in cyclical debt. And in just this year the United States has witnessed the imprisonment of several corrupt payday lenders, proving the industry's past of predatory practices. One of these men went as far as to establish his incorporation on federally protected Native American land to bypass payday loan tax regulations, generating billions in profits in less than twenty years. Meanwhile, the institution designed to protect consumers from predatory lenders is experiencing a toxic identity crisis, with several name changes to the organization, and whistleblowers claiming the organization's Trump appointed leader is favoring the payday lenders as a means to ensure career-advancing investments.

The payday loan industry is now a $9 billion industry, with over 11 percent of U.S. adults having taken out a payday loan within the last two years. With a national annual percentage rate on a payday loan at 400 percent (which is extremely high when compared to the average credit card APR at 16.96 percent), most payday loan borrowers are rolling over their loan due to the inability to pay the astronomically high finance charges. These charges tend to be service fees and accrued interest. Once a payday loan has been rolled over, a new loan is taken out to pay off the first.

Many of the unbanked and underbanked people in this country have turned to payday lenders to make ends meet, taking out short term loans to tide them over until their next paycheck. But with annual percentage rates soaring up to such high rates, many borrowers find themselves unable to repay the loan in time. So many borrow a second payday loan. Or a third. Since payday lenders require access to borrower's checking accounts in order for the borrower to be approved for the loan, many customers start to accrue hefty overdraft fees that become impossible to overcome, resulting in eventual loan defaults and even bankruptcy. The average American filing for bankruptcy is only $26 a month away from being able to afford their cost of living.

As more and more Americans find themselves trapped in cyclical payday loans with no end in sight, the institution designed to protect them from predatory practices is changing. Mick Mulvaney, the Trump appointed leader of the Consumer FInancial Protection Bureau, has begun to push to reverse an Obama era rule designed to protect Americans from predatory lenders. Mulvaney, who has already made attempts to shut down the agency altogether, has been working to easy the restrictions that have been placed on payday lenders, as well as auto-title and other high-rate installment loan lenders. The Consumer Financial Protecting Bureau had previously introduced a rule requiring these lenders to first verify the borrower's income before the lender could move forward with the loan. The rule only recently went into effect, but already Mulvaney has pushed the CFPB to request compliance dates delays - a request a federal judge has already ruled against. Without the assurance of the bureau to protect American citizens

from predatory, alternative financial options, these people will continue to find themselves in cyclical debt, unable to pull themselves out of poor financial standing, limiting themselves from the purchase of a home, or even a car.

The state of Michigan is a prime example of they payday industry's effect on financial health. With average payday loan annual percentage rates in the state equaling approximately 340 percent, and 91 percent of borrowers re-borrowing within 60 days, many low-income customers are struggling to repay these loans back. But this problem doesn't only affect the borrower - it also affects the economic health of the state. Right now over two thirds of payday loan stores in the state of Michigan are owned and operated by out-of-state lenders, which equates to millions of dollars leaving Michigan each year. The Center for Responsible Lending has reported that Michigan communities with high concentrations of people of color are being specifically targeted by payday lenders. Jessica AcMoody, Senior Policy Specialist with the Community Economic Development Associate of Michigan, sees payday loans as a "high-cost solution to a short-term problem" that are "built to take advantage of borrower's financial vulnerability." AcMoody believes there needs to be more consumer education in order to warn borrowers about the financial risks of taking out a payday loan, as well as the need for policymakers in the state to consider implementing interest rate caps, which other states have been introducing as a way to provide more protection for financially vulnerable customers. Currently 15 states, as well as the District of Columbia, have implemented payday loan interest rate caps at 36 percent or less. Most recently, the state of Colorado introduced legislation that could place interest rate caps on payday loans.

The state of Minnesota is now at risk of short-term lenders providing loans at interest rates normally deemed illegal within the state[13]. Within the past few months there have been two bills proposed to Congress which could potentially encourage payday lenders in Minnesota to charge APRs on payday loans that would exceed the state limit.[14]

Interest rate caps are unique per state, and banks, including branches of national banks, are held to the caps of the state in which they are located. The first bill, which was proposed by Trey Hollingsworth, an Indiana Republican, seeks to exempt "insured depository institutions and insured credit unions from the payday lending rule"[15], essentially allowing banks and credit unions to bypass the state mandated interest rate cap if they are not located in their home state. The bank or credit union would simply be held to the interest rate cap of their home state. If this were to come to fruition, a national bank based out of Utah would be able to utilize their Minnesota branches to provide loans with interest rates that are in accordance with Utah's interest rate cap, not the cap in Minnesota. This move could potentially give payday lenders located in another non-regulated state the ability to charge the same high annual percentage rates.

There are also comparisons being made to the current financial climate of the payday industry and the subprime financial crisis only ten years ago. Leading up to the 2008 subprime mortgage lending crash, banks eased their standards and began to provide subprime home mortgages to borrowers with low or poor credit scores. The banks packaged the loans into "mortgage-backed securities" and were given high credit scores which in term made them benefit from "insatiable demand by global investors for

residential mortgage securities". That drove the demand for subprime mortgages, inducing lenders to steadily lower their underwriting standards, which resulted in high-risk borrowers. Once the Federal Reserve began to increase rates, the rates for the subprime loans, which are not fixed, rose as well. Consequently, borrowers were left with rising mortgage payments they could no longer afford, which resulted in a high quantity of loan defaults. Now banks are providing similarly structured loans called leveraged loans.These loans are provided to corporations which are already high in debt and also have poor credit ratings, with the loans being tied to company assets as security in the situation of default.

The many red flags within the payday industry point to how volatile the economic stimuli the country receives from it. With such little regulation in many states, and lenders ruthlessly attempting to bypass rules in regulated states, the heart of the industry proves its predatory tint.

The Potential of Post Office Financial Services in Collaboration with Fintech

The current financial climate in the United States has created a scenario that is prime for Financial Technologies. FinTech has already been a driving force across the globe in establishing banks at a low cost, offering customers checking and savings accounts, as well as financial planning services, debit cards, and even loans. While the costs of running a brick-and-mortar bank branch continue to rise, FinTech is filling in the gaps, and the banking community is starting to notice.

However, the existence of a physical bank is still very crucial to the financial health of a community. While FinTech has already closed the physical, geographical distance between brick-and-mortar banks and customers, technology alone cannot solve the issues that exist from the large amount of bank closures nationwide. Americans still need a brick-and-mortar branch if they are to build their wealth and access lines of credit. But while FinTech may not yet have the resources needed to begin building bank branches and expanding across the country, they also may not need to. Those brick-and-mortar branches may already exist.

In 2014, the United States Postal Office performed a study and found that almost 60 percent of post offices are located in communities with only one bank branch in the area, as well as bank deserts. These post offices are reaching millions of Americans on a daily basis, including the unbanked and underbanked. The United State Post Office may hold the key to improving the dwindling financial health of Americans - with select offices also operating as simple banks.

The concept of the post office operating as a bank is not new. In fact, the post office offered savings accounts to Americans up until 1967. But the concept was just recently resurrected by Senator Kirsten Gillibrand of New York, who recently proposed the Postal Lending Act. The Postal Lending Act would add a retail bank to each of the post office's 35,000 branches, extending "low-cost, basic financial" banking services to millions of Americans. Gillibrand believes the initiative could effectively end the predatory practices of payday lenders nationwide as the postal service's network is essentially ubiquitous, reaching far into the depths of the country. And if the bill were to pass, it could create up to $8.9 billion in revenue per year.

The integration of banks into all 35,000 postal office locations would be an extreme undertaking, and unnecessary if the main mission of the initiative is to eradicate predatory lending practices from the states. If the bill were to initially focus on targeting the unbanked, underbanked, low-income and underserved communities that are already suffering, the initiative's success would be much easier to measure. Post Offices are already offering money orders, so locations with high amounts of money orders could also indicate key locations for the first phase of bank locations.

The bill's success rides on the ability to efficiently integrate a simple bank design into selected post office locations. Training current postal workers on the bank product offerings will distract from their current jobs, and will only increase the cost of overhead to run the banks. A simple solution would be installed interactive teller machines, a successful product already being used at banks across the country. The device looks like a standard ATM, but comes with video conferencing capabilities. Bankers can deposit checks, withdraw cash, apply for small loans, and manage their savings

accounts. Customers in need of help will be a button push away from qualified assistance, without the costly need of trained, on-site employees. Established bank branches already have similar ITMs in place, with customers quickly adapting to the new technology, with some banks already experiencing almost 40 percent of all bank transactions being done through the interactive machines.[6]

The potential is much greater than just the physical implementation of banking services in our nation's postal offices. If the USPS were to partner with a compliant, top-tier FinTech organization, the opportunities would only grow in scope. Customers could access their funds online, examining debit card transactions, allocating funds to their savings accounts, and other basic banking features so many Americans with a checking account are already familiar with.

The partnership with a leading FinTech outsourcer would be critical to the success of the initiative. Strong contenders up for the challenge are already in place. Fiserv, a top global provider of financial services technology solutions, has already partnered with a community credit union in New York - implementing their financial solutions to provide customers with efficient, integrated mobile, online, and in-branch experiences.[7] The bank can now offer customers wire transfers through their online banking portal, a piece of their now completely integrated "digital ecosystem".

The concept is already in motion outside North America. In Brazil, a FinTech firm named conta.MOBI has partnered with Correios, the state-owned organization that operates the national postal service for Brazil. conta.MOBI's technology has enabled millions of Brazilians to make bank deposits and withdrawals through the Correios network. Other countries are also offering bank services through local post offices. Germany's Postbank provides lending, insurance, and even brokerage services. Japan Post Bank Co. in Japan offers post office banking services as well, and was reported to be the world's largest deposit holder just ten years ago. FinTech companies have been working on the African continent to create digital wallets - wallets enabled on their mobile devices in which customers can open checking and savings accounts, and even contribute to their pensions. With so many countries utilizing their pre-existing post offices to offer banking services, as well as the growing number of FinTech companies implementing their digital opportunities, the United States is poised to join.

Gillibrand's vision of eradicating predatory lending practices comes into focus when examining the post office's ability to provide loans to the unbanked, low-income communities that are being targeted by payday lenders. While payday lenders charge a steep premium to borrow a loan, the interest rate is designed to compensate the lender in the case of a default. However, the post office is able to operate with significantly less overhead than a typical payday lender, and is also able to benefit from economies of scale - the post office's existing infrastructure and customers who already driving significant profit. (In just the final quarter of 2017, the USPS reported revenue of $16.7 billion.[8]) This is why the USPS reported in their 2014 whitepaper that they could offer a $375 loan with interest and fees totally a mere $48, compared to the hundreds of dollars in fees a typical payday loan would accrue.[9] If the post office encounters a loan on the verge of default, they have already hinted at the possibility of utilizing the Treasury Department's offset program - a program that allows federal agencies to collect debts from the tax refunds of debtors. The risk is simply not comparable to the risk taken on by

typical banks, or even payday lenders. The ability of the post office to offer short-term loans in communities overwhelmed with alternative financial providers at such a low cost would revolutionize the payday lending industry. Payday lenders would either need to follow suit and lower their fees and interest rates, or change their business model entirely.

Conclusion

While so many Americans are currently without banking services, there is hope for the future. Senator Kirsten Gillibrand's Postal Lending Act reveals the potential to utilize a network of physical buildings that already exist that could be used to offer underserved Americans the ability to improve their financial health. With the collaboration of FinTech, the United States Postal Office could offer millions of Americans basic banking services, eliminating the need for Americans to borrow payday loans at exorbitant interest rates and continue to risk their financial future.

The protection of million of American's financial health is possible, and the inability to provide access to essential basic needs is a thing of the past. The infrastructure is already in place, and the growth of a booming FinTech industry is expanding the boundaries of what personal finance management can look like. It has already proved its worth globally. As countries move forward in legislation designed to reach as many citizens as possible with banking institutions, so too should The United States be making efforts to follow.

Kirsten Gillibrand's proposal to establish post offices as banking centers should be the catalyst for the economic change of millions of struggling Americans. A strategic partnership with a FinTech organization could establish banking accessibility that hasn't been seen in decades. It would provide the ability to successfully pay off habitual debt, begin to grow savings accounts, open up access to small loans and eventually small business loans which would inevitably spur economic growth for the nation.

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