

Would you pay up to 1000% interest on a loan? The mere notion seems absurd. Yet this is the reality faced by an increasing number of urban Canadians who have no alternative.

Is There An Alternative to Fringe Banking?

One community's response to the financial services void

Decades ago, Winnipeg's North End was a thriving, industrious community. But conditions deteriorated. Income levels, employment, housing values, commercial vacancies, and bank branch closures all demonstrate how the North End experiences more poverty than does Winnipeg overall.

Communities that are poor have less money to place in savings, less money to purchase RRSPs and GICs, fewer mortgages to pay (because home ownership is less possible), less capacity to make loans, fewer businesses to use banking services, and less access to the telecommunications that decrease a bank's costs per transaction.

As a result, poor communities become less profitable for banks and they close their branches there – a phenomenon common in many rural and urban communities across Canada. Growing income inequality and the current drive of

banks to become “globally competitive” and meet shareholder expectations accentuate this trend.

The Fringe Banking Sector

Pawnshops, rent-to-own firms, tax refund advancers, cheque-cashing firms, and payday lenders – “fringe” financial services occur on the margins of the financial system. They essentially provide credit at rates that are significantly higher than mainstream costs when compared by Annualized Percentage Rates (or APR, i.e., when their interest rates, including all related fees, are calculated in annual terms):

- *Pawns* are 30-day loans secured by an item such as a TV or jewellery. Average repayment for a \$100 loan is \$125 (300% APR).
- *Rent-to-owns* provide items for monthly payments. Interest averages 305% APR.
- *Tax refund advancers* loan you the amount of your return (minus fees) secured by your tax refund. Interest, based on \$500 income tax return (when calculated as a 10-day loan), averages 286% APR.
- *Cheque cashing* becomes a form of loan when a person doesn't have a bank account, or his/her account balance is less than the value of the cheque and the 5-day hold is onerous. The person

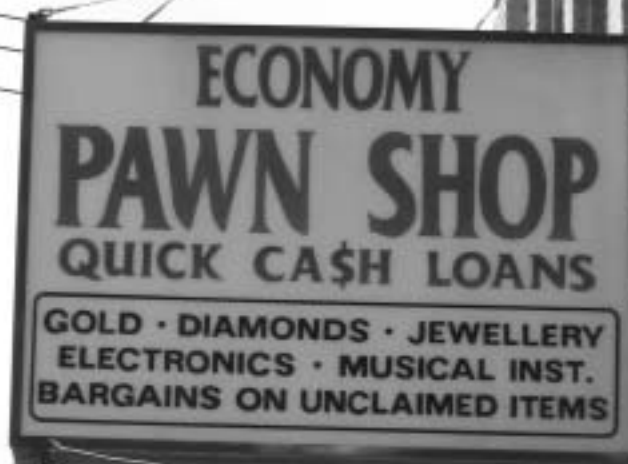
BY BRENDAN REIMER

who turns to a fringe outlet to cash the cheque pays a fee that can be understood as the interest on a 5-day loan, secured by the cheque itself, averaging 210% APR.

- *Payday loans* are secured by the wage-earner's next paycheck. Prices are diverse, ranging from a low of 468% APR for a \$100 loan to a high of 988% APR (or \$132 for a 2-week loan of \$100).

One could argue that fringe financial service outlets fill credit voids in poor communities and that the higher fees simply reflect the costs of providing short-term, high-risk credit. In fact, some say that access to fringe services keeps some customers from resorting to criminal activity in order to meet their financial needs.

However, the reality is that the fees are exorbitant, particularly when measured as a percentage of the customers' disposable income. What is actually emerging is a 2-tier banking system where low-income people pay much more to cash their cheques and access credit than the rest of society does. It does not contribute to the financial health of the individual or the community. As one community member commented, “Poverty is a booming business. Someone is making a lot of money off people who don't have much to begin with!”



Yet government does not yet seem overly concerned about this trend. So the responsibility for developing healthy responses will necessarily rest with communities, with critical support from government, banks, credit unions, or other key stakeholders.

The Community Responds

That's what has been happening in Winnipeg's North End. A bank exodus in the 1990s and a corresponding growth of the fringe banking industry left North Enders with fewer and fewer options. Between 1980 and 2003 the number of bank and credit union branches in the North End fell from 20 to 5, while the number of fringe banks (excluding tax refund advancers) grew from 1 to 19. (See diagram, next page.) The most dramatic growth nationally has occurred in the payday loan sector, where the number of outlets has exploded from zero to 1200 in the last decade.

North End Community Ministry, a United Church outreach program, began working with other concerned community organizations and residents, and in 1997 formed the Alternative Financial Services

Coalition. Initially, the AFSC hoped that opening a credit union in the North End would solve the problem, but existing credit unions were neither willing nor able to open a branch there at the time.

Undeterred, the AFSC went after smaller, more achievable initiatives instead. They knew that low-income people were paying high fees for tax preparation services and even higher fees for quick refunds. But they also became aware that many were not receiving GST refunds because they could not even afford to file a tax return. So North End Community Ministry decided to host a free income tax processing centre. There, volunteers now process tax returns for hundreds of low-income North End residents each season, saving them thousands of dollars in preparation fees and securing them thousands more in GST cheques. They take a working-with approach so that the individuals who are interested can learn to process income tax returns themselves.

The AFSC also addressed the savings and education gap by bringing an Individual Development Account (IDA) program to Winnipeg. Not only did they participate in the *learn\$ave* national

demonstration project, they found funding to set up several other matched savings programs as well. To date, more than 200 people have participated in the financial management programs and saved more than \$75,000 of their own money. It has been matched 3:1 for a total savings of nearly \$300,000 toward housing, micro-enterprise, education, and household items.

However, the AFSC knew that these efforts did not meet the real need for affordable credit. It began to explore the pawnshop sector through sample transactions and a survey of average costs. The AFSC even considered setting up a community pawnshop and used furniture store, but finally decided against it. Community distrust of pawnshops runs very high, and the business would have harmed several local family-owned used furniture stores.

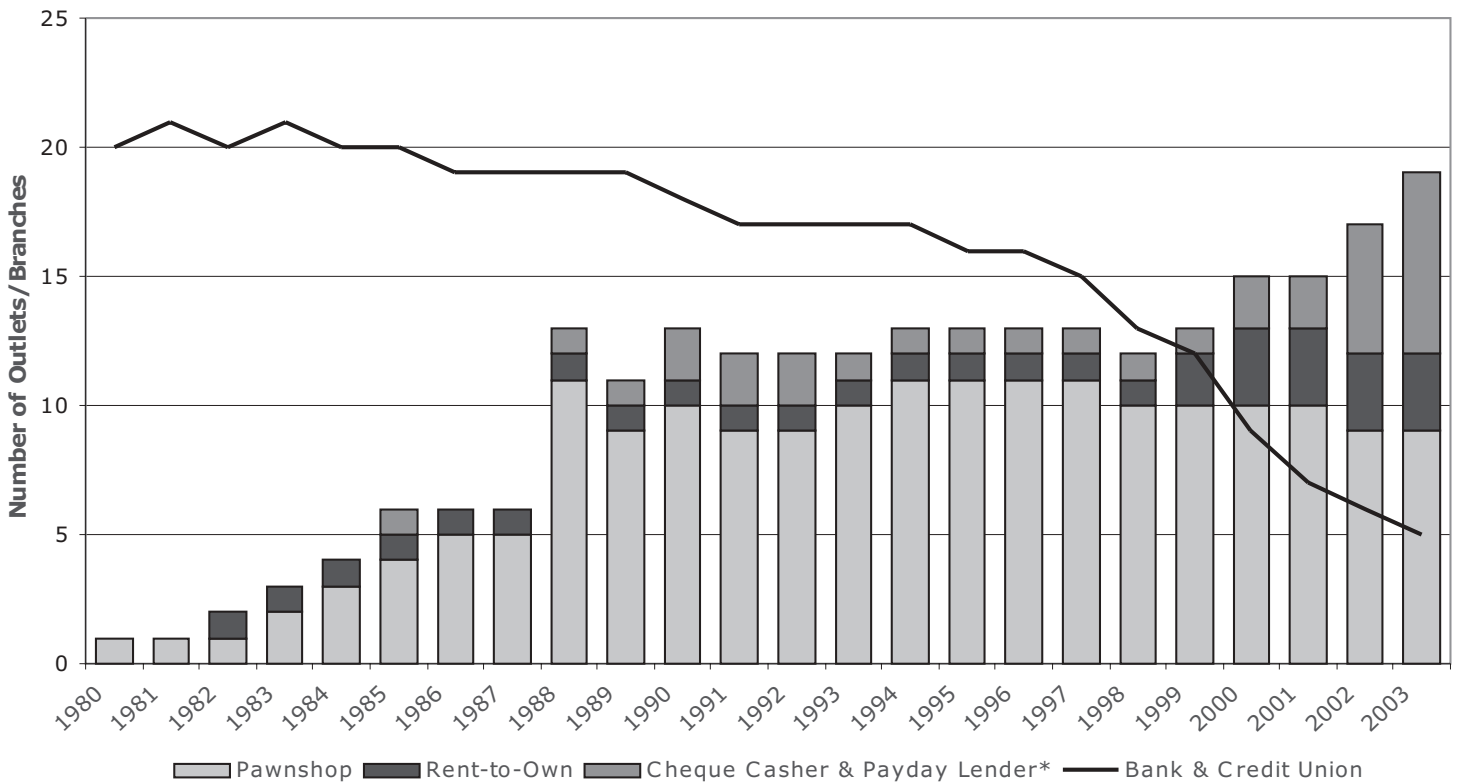
The Research Project

The AFSC and the North End Community Renewal Corporation then approached the Winnipeg Inner-City Research Alliance, a community-academic joint research initiative at the

The corner of Salter and Selkirk Avenue used to be the hub of a bustling Winnipeg business sector anchored by a bank. Today, the intersection is occupied by one of the city's largest pawnshops and a Money Mart outlet providing fringe financial services.



**Approximate Number of Fringe & Mainstream Banks
in Winnipeg's North End, 1980-2003**



University of Winnipeg. They asked the Alliance to explore the fringe banking industry and community-based responses to it in North America, and to develop a pre-feasibility study on a potential alternative for the North End. Two professors, Dr. Jerry Buckland and Dr. Thibault Martin, together with three student researchers and two community researchers made up the research team. Blair Hamilton, a CED consultant, was contracted to do the pre-feasibility study.

An important aspect of the research was to determine why people use fringe financial services. Interviews with 41 clients revealed the following common reasons:

- lack of bank accounts
- lack of deposits required to avoid 5-day holds on cheques
- lack of personal identification
- the convenient hours and locations of fringe outlets.

As one respondent said, "It was nearly impossible to bundle up my four small children in winter to walk six blocks to

the bank, never mind travel out of the North End to find one now." There is a direct correlation between low income and poor transportation, and therefore also to fringe financial service use as mainstream services are difficult to access. Many respondents also stated that they felt banks and credit unions discriminated against them and opted instead for the friendlier services at the fringe outlets.

The interviews also revealed informal lending networks among North End residents. Smaller (\$5-20) loans are made monthly for various expenses and paid back – without interest – when the next employment or Employment and Income Assistance (social assistance/welfare) cheque arrives. In turn, the cheque recipient would lend out small amounts of money to needy friends or family. A small amount of credit continuously circulated within small groups of individuals, demonstrating an innovative community response to access to credit.

Alternative Models

What, if anything, can be done? You cannot force the banks to return and yet the firms that fill the void do not offer affordable financial services to the community.

A provincial NDP government established Four Corners Community Savings in Vancouver's Downtown Eastside in 1996. Established as both a

Chart data source: Winnipeg Yellow Pages Directories and Outlet Follow-up

* Until 1990 Money Mart was the only firm in the cheque-casher category in the telephone directory; for 2001-2003 Money Mart was listed under cheque-cashing services and loan categories. (There were seven Money Mart outlets in 2001, and nine in 2002).

The number of payday loan outlets is the sum of the number of firms offering payday loans in the loan category in the telephone directory and, for 2001-2003, the number of Money Mart outlets.

Payday lenders and cheque cashers are the number of payday loan outlets plus the number of Money Mart outlets. In 2003 there was only one cheque-cashing outlet that did not offer payday loans.



Are fringe banks a credit mechanism or predatory lending? Consider the “roll-over.” With roll-overs, you just pay the interest on a payday loan or pawn and renew the loan for another month. Unable to repay the principal and interest 30 days later, clients can, and frequently do, “roll over” the loan for several months, ultimately paying the lender many times the original amount.

Compounding the problem is that some people have to make a second loan at another fringe bank just to pay the interest on the first. One couple, who began with a \$250 loan, spun into a cycle of debt in which they borrowed several thousand dollars in less than three years and had nearly \$20,000 in interest payable to various lenders. One 18-month \$520 loan cost them more than \$5000. Some payday lenders and pawnbrokers actually encourage roll-overs in order to realize considerable profits.

(left) One of several pawnshops now operating in Winnipeg’s inner city.

bank and a crown corporation, Four Corners provided free financial services (deposit accounts, bill payments, cheque-cashing, etc.) to low-income individuals. (A \$3.50 monthly fee was introduced in 2003.) Four Corners hired locally, provided services in several languages, provided meeting space for community groups, and brought in job information kiosks to assist those seeking employment.

Four Corners lost money every year, however. In time it eroded its initial share capital of \$10 million to less than \$5 million, below which a bank is not allowed to operate. These losses, and the advent of a new provincial government, led Four Corners to close its doors in April 2004. While Four Corners may have met community needs in an affordable manner, its organizational and fee structures were simply not viable.

Another model to consider was that of Cash and Save in Toronto. Set up by the Royal Bank of Canada in 2002, Cash and Save offers cheque-cashing, money orders, and bill payments, but no access to credit, bank accounts, or savings programs. Its services include no educational/transitional component either. Nevertheless, early indications are that this model will be a sustainable service to the community for many years.

Credit unions have also developed several responses to fringe financial services. VanCity created a means by which people could secure a line of credit with a \$100

deposit. As they improved their credit rating with repayments, they could borrow more and eventually gain access to unsecured credit. The process included educational and savings components as well.

The Desjardins *caisse populaire* established a no-interest microloan fund through which 259 loans have been made totalling \$131,279 (\$527 average). Although nearly 70% of the customers have had incomes under \$10,000, the reimbursement rate is 92%.

In 2000, Florida Central Credit Union (FCCU) partnered with a community development corporation to set up a Credit Union Service Organization (CUSO) that provided cheque-cashing, bill payment, and payday and car title loans. The goal was to provide an affordable alternative to fringe outlets while using the CUSO as a transitional mechanism to draw those clients into the credit union, where these services were even cheaper. When state funding for the community development corporation terminated, however, so did the CUSO.

In 2001, the North Carolina State Employees Credit Union (NCSECU) began offering an alternative to the payday loans when they noticed how payday lenders were increasingly taking advantage of their members. Members can now borrow up to \$500 until their next payday at just 11.75% APR. With 38,000 of NCSECU’s one million members using this service, the demand is high, it is plain to see. Calculating how much more these

advances would have cost at fringe banks provides insight into the profits being made. This calculation also reveals how important alternatives, like that of NCSECU, are to keeping assets in the hands of these individuals. And, in order to build up the member’s asset base so that s/he will be less likely to need these loans in the future, NCSECU places 5% of the loan into a savings account that acts both as collateral for the loan and as an accessible asset for that person once the loan is repaid. As well, all members are offered free financial counselling services.

Finally, back in Vancouver’s Downtown Eastside, PHS Community Services Society (a local nonprofit housing organization) has partnered with VanCity to open a financial services outlet in the neighbourhood where Four Corners once operated. Membership at Pigeon Park Savings costs \$5 monthly and offers access to a basic savings account with unlimited transactions, ATM transactions (their own and VanCity’s), bill payments, electronic debit transactions, and counter cheques. PHS Community Services also plans to begin an IDA program for local women this fall. Pigeon Park staff will include people who know the community well. This will alleviate problems with personal identification; the outlet will even be able to waive the 5-day hold on most cheques. The cost of the lease is virtually nil and renovations to the premises were done for free by supportive individuals and organizations.

What is emerging is a 2-tier banking system where low-income people pay much more to cash their cheques & access credit than the rest of society The responsibility for developing healthy responses will necessarily rest with communities, with critical support from government, banks, credit unions, or other key stakeholders.



"VERY GOOD. NOW - CAN I TROUBLE YOU FOR A LOOK AT THAT SHIRT?"

Key Issues for Alternative Models

It's no easy thing to design, a sustainable model that meets the immediate needs of individuals while contributing to their long-term financial health. People need access to affordable cheque-cashing, small loans, and deposit accounts. They also need opportunities to improve their financial literacy, money management skills, their credit rating, and accumulated savings. Then there is the challenge of delivering the services in a financially viable manner, either through a self-sustaining structure, or through long-term subsidization.

In fact, it may be that a self-financing model that includes both inexpensive financial services and an educational component is not possible. Cash and Save does not include the latter. Four Corners and the FCCU closed without ongoing subsidies. VanCity, Desjardins, and Pigeon Park are internally subsidized.

If nonprofits could provide this type of comprehensive and affordable service, they likely would. And if the market would support such an initiative, they too would exist. As neither sector seems able to deliver independently, something new is required. What will this innovation look like?

For one thing, it will involve multiple stakeholders. Multiple stakeholders spread the risk and provide access to a diversity of strengths, capacities, and expertise. A bank or credit union partnership is critical, because they possess the capacity, expertise, and economies of scale in the provision of financial services. Large banks or credit

unions also have the resources to develop financial alternatives independently of public funding, with all its long-term unpredictability.

Electronic transactions will be another important aspect of this innovation. Research by Four Corners revealed that community safety increases when fewer people carry cheques or cash. This safety leads to savings in cheque replacement costs as well as policing and health costs.

Finally, the innovation will be both replicable and flexible. That is, it will be transferable between communities, but will likely look different from place to place, for each community has its unique strengths and challenges.

Handing the Research to the Community

In September of 2003, a workshop to release the AFSC's final research report included presenters from the research team, credit union representatives, community leaders and development practitioners, and representatives from Desjardins and FCCU. Representatives of the Canadian Imperial Bank of Commerce (CIBC) also attended – something of particular interest to the community. In the course of the research, CIBC had closed its last branch in the North End despite fierce community opposition. However, CIBC had also committed to support the community in its pursuit of a viable, alternative source of financial services.

After the workshop, someone asked, "So now what?" As it was not in the mandate or capacity of the research team to continue, the community knew that it would have to respond. The AFSC took

up the challenge once more, with continued support from a research team representative and the North End Community Renewal Corporation. Neighbourhoods Alive!, a provincial community development fund, and the CIBC provided funding to prepare a business plan for providing community financial services. CIBC also provided technical support and advice in the design of the model.

The Community Financial Services Centre, while still in the development phase, will likely involve links or partnerships with a variety of other

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organizations in the community. It will not provide cheque cashing, but will encourage customers to utilise direct-deposit options so that their money is accessible through ATM machines and manageable through computers placed in local organizations. Special no-fee accounts will be created by a local credit union for the electronic transaction process. The service centre will also provide a list of local merchants who will cash cheques or provide cash-back with purchases. To address the issue of identification, the service centre will develop a photo ID card for less than \$10. Merchants have indicated that they would cash government-issued cheques if shown the Centre's ID card.

The service centre will also provide small loans (\$40-100) for terms of 30, 60, or 90 days at 36% APR, which is intended to cover loan losses. For references, loan applicants may turn to 6-8 community organizations with which they have established relationships. Again, businesses have indicated a willingness to recognize this referencing system.

Transitioning people from reliance on fringe financial services to participation in mainstream financial institutions will be an important focus of the centre, with electronic transactions being an important tool. Benefits include decreased cost of service, safety, as well as 24-hour and increased geographic accessibility.

However, getting used to this type of system may be a challenge. Many people really like in-person transactions and don't trust or understand technological mechanisms. This is why the service centre will work at educating the community on how to use the various mechanisms and providing easily accessible locations. The progression of individuals to the mainstream will be essential to taking on new participants.

The financial service centre that AFSC is considering will be a flexible, transitional initiative. It will try to meet residents' immediate needs in an affordable manner while helping them gain access to mainstream financial services through education, personal identification,

and deposit accounts, and improved credit ratings as the loans are paid off at the local credit union that administers them. Our next challenge is to attract the resources required to establish the facility. Only then will we be able to test the model's capacity to make a long-term educational, economic, and empowering impact in the community.



A student researcher on the AFSC project, BRENDAN REIMER is a member of the Canadian CED Network (CCEDNet) and is its Regional Co-ordinator for the Prairies and Northern Territories. Brendan studies Sociology and International Development at the University of Winnipeg. He is researching CED-oriented business development strategies in Winnipeg's North End for Jerry Buckland of the University of Winnipeg (Menno Simons College) and for the North End Community Renewal Corporation. Brendan is also co-chair of LITE, a fundraising organization that supports CED initiatives in Winnipeg's inner city. He wishes to thank Blair Hamilton of Dunganon Consulting, Andrew Douglas of the AFSC, and Jerry Buckland for their input into this story. All photos courtesy of Brendan Reimer.

For a copy of the complete research report, contact Brendan at (tel) 204-927-3203, (e-mail) breimer@ccednet-rcdec.ca.

Plan ahead:

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