Starting a Small-Dollar Loan Program for Your Employees

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An employer-sponsored small-dollar loan (ESSDL) can make a big difference in the lives of employees who lack access to affordable credit. As a low-cost, highly valued employee benefit, small-dollar loans may also meet important needs for companies. This checklist is designed to help employers understand the choices and trade-offs among different employer-based loan programs. For a detailed report, see ***Employer-Sponsored Small-Dollar Loans: A Survey of Products and Employers*** (Urban Institute, December 2020).

WHO IS THE LENDER?

ESSDLs are offered by banks, credit unions, consumer finance companies, and other providers. The type of lender may affect the loan design.

- ☐ **Banks** are for-profit depository institutions. ESSDLs originated by banks may help un- or under-banked borrowers develop a relationship with a financial institution and a savings habit.
- ☐ **Credit unions** are nonprofit depository institutions that serve their members. Borrowers will be required to become a member of the credit union by opening a depository account, which may help un- or under-banked borrowers develop a relationship with a financial institution and a savings habit.
- ☐ **Consumer finance companies** are for-profit nondepository loan providers.

HOW IS THE LOAN DELIVERED?

Loans delivered through fintechs (financial technology companies) and those offered by regional or local lenders have comparative strengths and limitations.

- ☐ **Fintechs** support the efficient delivery of financial services. Loans made by any type of lender can be delivered through a technology platform. A fintech may provide the best ESSDL solution for larger companies or those with employees in multiple locations; companies that lack human resources capacity or prefer less direct involvement with employees' personal finances; or companies that lack access to a local lender.
- ☐ **Local or regional ESSDL providers** serve employers in a defined geographic area. Local ESSDLs are often provided as part of a more comprehensive employee financial wellness program that includes other services, such as financial education, one-on-one coaching, and referrals to local resources. These services may be voluntary or required as a condition of the loan.

EMPLOYEE BENEFITS MAY INCLUDE

Fast access to emergency credit

Lower cost of credit than payday loans or retirement plan loans or withdrawals

Convenient repayment through payroll deductions

Improved **banking relationships**

New or improved **credit**

Increased **emergency savings**

EMPLOYER BENEFITS MAY INCLUDE

Reduced unplanned absences and turnover caused by financial emergencies

Increased worker productivity by reducing financial stress and distractions

Increased employee satisfaction

Reduced employer administrative costs for retirement plan loans or withdrawals and wage garnishments

Reduced risk to employers from one-off hardship loans

WHAT DOES THE LOAN COST?

ESSDL providers employ different fee structures that may include costs for both the employer and employees. Employers should ensure that costs are fair, transparent, and easily understood by borrowers.

- ☐ **Employers.** Some ESSDL providers charge employers a set-up fee and/or an annual fee based on usage and charge-off rate. Lenders may also offer flexible terms or add-on services.
- ☐ **Employees.** Borrowers may pay application fees, fees for pulling a credit report, or finance charges in addition to the loan interest rate. Borrowers may also encounter late payment or early payoff fees.

WHAT IS THE PURPOSE OF AN ESSDL BENEFIT?

ESSDLs meet needs for employers when they help employees handle financial emergencies, stay on the job, and avoid predatory lenders. Loans designed to help employees who need them most (those with limited or poor credit histories), include the following features:

- ☐ Borrower ability to repay determined by income and length of employment in good standing and not on credit score
- ☐ Maximum loan amount determined by the employee's income
- ☐ Loan repayment between 3 and 12 months
- ☐ Repayment through payroll deduction (or similar automatic repayment plan) required
- ☐ Repayment reported to credit bureaus, which can build or improve a borrower's credit score over time
- ☐ Loans restricted to one at a time, with a limited number of loans permitted over a given period

WHAT ELSE CAN EMPLOYERS DO?

For ESSDLs to meet their potential, they must be preferred by employees over payday or auto title loans and be easily accessible to workers without stigma.

- ☐ Ensure that the loan application process and receipt of funds is competitive with the speed and convenience of payday lenders
- ☐ Link ESSDLs to opportunities to help employees save
- ☐ Make loans available to all employees
- ☐ Protect borrowers' privacy

Employers can also collaborate with lenders, nonprofit partners, and other employers to **create or customize loan products** that align with company and community needs and support employee financial well-being.

APR OR INTEREST RATE?

The **interest rate** on a loan might understate the true cost of borrowing if the lender charges fees to access the loan. The **APR** adds fees associated with the cost of borrowing to the interest rate and represents the annual cost to the borrower. Some fees may not be included in the calculation of the APR.

ESSDL OR PAYDAY LOAN?

Despite relatively high APRs, ESSDLs with principled terms can help employees avoid a devastating cycle of debt caused by reliance on payday loans. Payday loans typically have short repayment periods and are frequently rolled over.

Cost of a $550 car repair paid bimonthly over three months:

	Payday loan	*ESSDL*
APR:	391%	19.99%
Bimonthly cost:	$150.42	$94.36
Total cost:	$902.52	$566.14

LEGAL AND REGULATORY FRAMEWORK

ESSDLs, like all consumer loan products, are subject to state and federal laws, rules, regulations, and other guidance designed to protect consumers. Regulatory protections differ by lender type or borrower category and are subject to change. Employer-based lending programs are also subject to state employment and labor laws that may alter how ESSDL benefits are designed or delivered. Employers should seek competent legal advice before implementing an ESSDL benefit.

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