Banks are trying to get a piece of the payday loan pie

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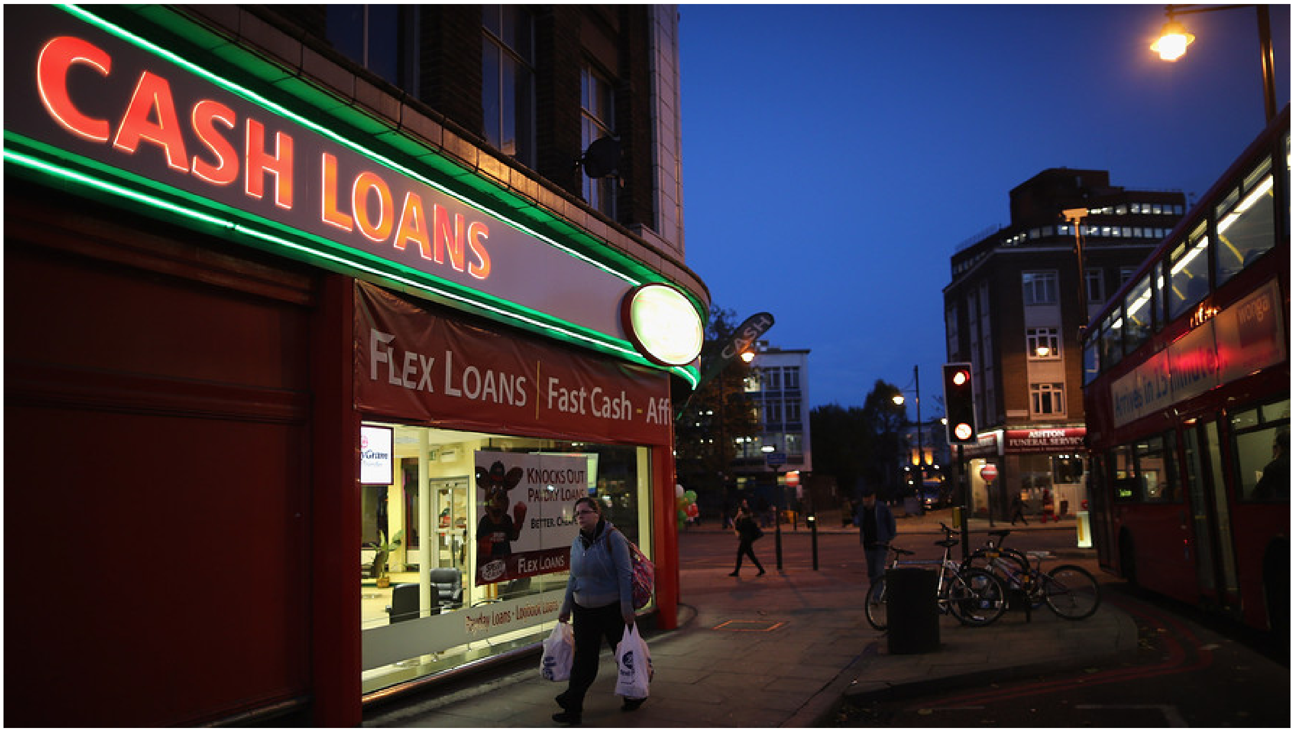

Where would you turn for some last-minute emergency cash?

The answer for many in recent years has been payday lenders, and more recently, online companies have gotten in on the act. More banks are moving in that direction. U.S. Bank, a division of U.S. Bancorp USB, +0.13% , this week announced “Simple Loan,” to help Americans who suddenly have to come up with cash in a pinch.

To qualify for Simple Loan, customers must have a checking account at U.S. Bank. They can borrow between $100 and $1,000. They then must pay the loan back in three months, with three fixed payments. Lynn Heitman, executive vice president of U.S. Bank Consumer Banking Sales and Support, said the loans provided a “trustworthy, transparent” option.

> “What are the odds they’ll be able to repay $100 at 15% interest in the next three months?”
> *Rachel Podnos, a financial adviser and attorney based in Washington, D.C.*

They don’t come cheap. If they pay directly through their bank account, through an autopay option, it costs $12 for every $100 borrowed. If they choose to pay without the automatic debit from their account, it’s $15 for every $100 borrowed.

That can quickly add up. As U.S. Bank states on its website: “If you borrow $400 and select automatic payments, your fee will be $48,” the bank explains. “You’ll pay back a total of $448 in three monthly payments of approximately $149.33 each. Your total cost to borrow (annual percentage rate) will be 70.65%.”

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That is comparable to what some payday lenders may charge, but far more than regular personal loans. States set limits for the maximum amount payday loans can cost in fees, and typically range from $10 to $30 for every $100 borrowed, according to the Consumer Financial Protection Bureau.

> 'Your total cost to borrow (annual percentage rate) will be 70.65%.'
> *U.S. Bank on its new small, short-term 'Simple Loan' product.*

In May, consumer advocacy groups including the Center for Responsible Lending signed a letter asking financial regulators not to allow banks to charge more than 36% APR. "This type of product isn't a safe alternative to a payday loan," said Rebecca Borné, senior policy counsel at the Center for Responsible Lending, in a statement.

U.S. Bank defended the charges. "We conducted a pilot between 2016 and 2017 and overwhelmingly heard from our customers that they found the pricing was easy to understand," a spokeswoman for U.S. Bank said. "In addition, during the application process, there are three distinct moments where customers are informed that this is a high-cost product, that there may be other options and to contact us if they would like to discuss those options."

Soon you'll be able to make payments without even thinking about it

U.S. Bank is one of several banks to debut small-dollar loans in recent times. Marcus, the consumer platform that is part of Goldman Sachs GS, -0.73% , debuted personal loans in 2016 with rates of 6.99% to 24.99% APR. TD Bank, based in Cherry Hill, N.J., also offers unsecured loans, with interest rates of 8.99% and higher.

Atlanta-based SunTrust STI, +0.28% bank has a national lending division called LightStream, which has offered unsecured personal loans since 2013. LightStream promises to beat other lenders' APRs, but they must be approved at the other lender's interest rate. Current rates range from 3.09% to 14.24%, when customers use autopay.

But considering the high interest rates many lenders charge, "I don't think people should take this lightly," said Rachel Podnos, a financial adviser and attorney based in Washington, D.C. Consumers should watch out for "origination" fees lenders might charge when the loan is distributed, or penalties for paying the loan back early. "I would be weary of these kinds of loans," she said.

There's been a surge in personal loan offerings

The banks are capitalizing on a trend. Personal loans are the fastest-growing type of consumer debt in the past year, according to credit agency Experian EXPN, +0.31% . Existing personal loan debt hit $273 million in the second quarter of 2018, up about 11% from the same quarter in 2017.

There has been a surge in the number of lenders offering loans completely online, including SoFi, Marcus, Prosper and Avant, Experian said. They also offer short-term, small loans. Some online lenders are less concerned with financial emergencies than customers who would like to borrow for luxury vacations.

> 'I've always felt that if you want to drive down the cost of payday loans, you have to have traditional banks in the game.'
> *Nick Clements, co-founder of MagnifyMoney*

Another obvious risk: Consumers may not be able to pay a loan back, and if it's collecting interest, they can get stuck in an expensive spiral. Companies are "marketing to people who don't have $100 or $1,000," Podnos said. "What are the odds they'll be able to repay $100 at 15% interest in the next three months?"

Nick Clements, co-founder of the personal finance company MagnifyMoney, who previously worked in the credit industry, said banks may be responding to the Trump administration's promise to relax financial regulations. For example, the acting director of the Consumer Financial Protection Bureau is viewed by some as being more business-friendly than consumer-friendly.

Banks are a better option than payday lenders and pawn shops, he added. "We can pretend the need doesn't exist, which leaves it to pawn shops and payday lenders, or we can empower banks to compete," Clements said. "Traditional banks have the lowest cost of capital, built-in distribution through branch networks, and I've always felt that if you want to drive down the cost of payday loans, you have to have traditional banks in the game."

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