United States Government Accountability Office

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Report to Congressional Requesters

January 2011

PAYDAY LENDING

Federal Law Enforcement Uses a Multilayered Approach to Identify Employees in Financial Distress

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GAO-11-147

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Highlights

Highlights of GAO-11-147, a report to congressional requesters

Why GAO Did This Study

In the United States, payday lending is estimated to be a slightly less than $40 billion a year industry. A payday loan is a small-dollar loan that is usually from $100 to $500 and repayable in a short term, usually 2 weeks. Consumers can pay fees of $15–20 for every $100 borrowed. In 2006 the Department of Defense (DOD) reported on predatory lending, including payday lending, and found that these loans impacted military readiness and troop morale. Concerns were raised about payday lending to federal employees in law enforcement and national security positions at four components—Customs and Border Protection (CBP), Immigration and Customs Enforcement (ICE), the Transportation Security Administration (TSA), and the Federal Bureau of Investigation (FBI). GAO examined (1) how these federal law enforcement agencies become aware of employees who are potential security risks due to financial problems, including payday lending, and (2) various alternatives to payday lending. GAO reviewed federal policies and procedures for collecting financial information and reviewed data from and interviewed representatives of the payday loan industry, depository institutions, consumer groups, nonprofits, and trade organizations.

GAO makes no recommendations in this report. We provided copies of the draft report to entities we reviewed and they provided technical comments that we incorporated.

View GAO-11-147 or key components.
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January 2011

PAYDAY LENDING

Federal Law Enforcement Uses a Multilayered Approach to Identify Employees in Financial Distress

What GAO Found

Federal agencies—including the Department of Homeland Security (DHS) components CBP, ICE, and TSA, and FBI—use a multilayered approach to assess applicants and employees for suitability and review certain employees for security clearances. As part of this process, the financial history of an applicant or employee is reviewed to identify those who may be in financial distress. The Office of Personnel Management specifies the minimum standards and procedures by which agencies conduct the investigations. In reviewing an applicant's or employee's financial profile, agencies primarily use credit reports from the three major credit reporting bureaus. Through this review, DHS and FBI officials stated that they are able to identify employees with financial problems although the primary data sources of financial information typically do not capture information on whether an individual has used a payday loan. In looking at an applicant or employee's financial history, officials at CBP, ICE, TSA, and FBI told GAO that they weighed an individual's risky financial debts or behaviors against the extent, circumstances, and severity of such debts and behavior. Agency officials stressed that they were not as concerned with individuals using payday loans as with patterns of debt or risky financial behavior, or how payday lending might contribute to such patterns. Despite payday lending not regularly being reported to major credit bureaus, agency officials felt confident that they captured an adequate amount of both applicants' and current employees' financial information to make accurate suitability and security clearance decisions. Data GAO collected on employee pay levels and a limited sample of data from the payday loan industry further suggest limited use of payday lending by employees who reported employment at CBP, ICE, TSA, or FBI.

Depository institutions, employers, and nonprofit organizations have developed a range of different products and mechanisms to provide short-term credit to those that need it. Some products may serve as alternatives to payday loans—mimicking some of the terms and conditions of these transactions but generally offering lower interest rates—while other products are offered to establish long-term relationships with borrowers or meet a need for short-term credit in the community where they are offered. Despite the different product offerings, the number of institutions offering small-dollar loan products is still relatively small. A number of institutions cited challenges to offering such products which include credit risk and concerns about the profitability of the product. Recent actions, including changes in federal legislation (for instance, to provide a loan loss reserve fund to help small lenders offset credit risk) as well as efforts by the Federal Deposit Insurance Corporation and National Credit Union Administration to increase depository institution interest in offering such products, could encourage greater availability of small-dollar loans.

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Abbreviations

APR	annual percentage rate
ATM	automated teller machine
CBP	Customs and Border Protection
CDFI	Community Development Financial Institutions Fund
CRA	Community Reinvestment Act of 1977
DHS	Department of Homeland Security
DOD	Department of Defense
EAP	employee assistance program
FBI	Federal Bureau of Investigation
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
FTC	Federal Trade Commission
HHS	Department of Health and Human Services
ICE	Immigration and Customs Enforcement
LEO-GS	Law Enforcement Officer-General Schedule
NCUA	National Credit Union Administration
OPM	Office of Personnel Management
TSA	Transportation Security Administration
SF-86	OPM Standard Form 86
TSP	Thrift Savings Plan

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Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

January 26, 2011

The Honorable Darrell Issa
Chairman
Committee on Oversight and Government Reform
House of Representatives

The Honorable Brian Bilbray
House of Representatives

In the United States, payday lending is estimated to be a slightly less than $40 billion a year industry. Generally defined, a payday loan is a single payment, short-term loan based on a personal check held for future deposit or electronic access to a personal checking account. Payday loans are available in most states, require minimal documentation, and can be approved within minutes. Industry representatives and studies report that the typical loan is usually for $100–500 and a 14-day term, and the cost to the consumer for this short-term credit can be expensive compared to some other small-dollar loans. Payday lenders with whom we spoke said that loans are priced at a fixed-dollar fee ranging from $15–20 per $100 borrowed, which is equivalent to an annual percentage rate (APR) of 300–600 percent. If a borrower is unable to repay the loan or does not have enough money in a checking account to cover the loan on the due date, the borrower generally can pay an additional fee to extend ("roll over") the loan—for example, for another 2 weeks if legally permissible in the state where the loan was taken out. If borrowers extend a loan multiple times or obtain consecutive loans, the payday loan cycle can continue for weeks or months, costing the borrower much more than the initial amount borrowed. For example, a $100 loan rolled over three times could end up costing a borrower $60 in fees as opposed to the $15 the customer initially paid. A number of consumer advocacy groups contend that payday loans are predatory due to the fees charged and a concern that borrowers will not be able to repay loans when they are due, trapping the borrowers in a cycle of debt. A 2009 report from the Center for Responsible Lending found that of the 19 million payday loan borrowers in the United States, nearly 12 million became trapped in the payday loan cycle and ended up with at least five payday loans per year.[1] The payday loan industry

[1]Center for Responsible Lending, *A 36% APR Cap on High-cost Loans Promotes Financial Recovery* (January 2009).

counters that it is providing a much needed service, without which consumers would incur even greater costs, such as fees for bounced checks or late fees on credit cards. According to the Center for American Progress and payday loan industry studies, many people who use payday loans do so for a variety of reasons such as gaining same-day access to needed cash and avoiding late and overdraft fees for bills or on bounced checks.

In response to growing concerns about the impact of servicemembers' financial difficulties on unit morale and readiness, in 2006, the Department of Defense (DOD) released a report about predatory lending, including payday lending, to members of the military.[2] DOD found that these loans impacted military readiness and troop morale. Following the DOD report, you raised questions about payday lending to federal employees in law enforcement and national security positions at the Federal Bureau of Investigation (FBI) and three components of the Department of Homeland Security (DHS)—Customs and Border Protection (CBP), Immigration and Customs Enforcement (ICE), and Transportation Security Administration (TSA)—and whether these employees could pose a security risk if they owed debt to payday lenders. In response to your request, this report examines (1) how select federal law enforcement agencies become aware of employees who are potential security risks due to financial problems, including payday lending, and (2) various alternatives to payday lending that provide consumers with access to small-dollar loans and more favorable interest rates.

To address these objectives, we met with officials at the Office of Personnel Management (OPM) and four federal law enforcement components that you identified—CBP, ICE, TSA, and FBI. We obtained information and documentation on the policies and processes these agencies follow when conducting a suitability or security clearance investigation of an applicant or employee. We examined the financial information that is collected and analyzed and spoke with investigators and adjudicators about how this information is used when determining suitability for employment or adjudicating initial or periodic security clearances. We also reviewed agency codes of conduct and other personnel standards that apply to the financial status of federal

[2]DOD, *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* (August 2009). GAO, *Military Personnel: DOD's Predatory Lending Report Addressed Mandated Issues, but Support Is Limited for Some Findings and Recommendations*, GAO-07-1148R (Washington, D.C.: Aug. 31, 2007).

employees. To understand if employees at these particular agencies were seeking help for financial matters we spoke with officials at the Department of Health and Human Services (HHS), FBI, CBP, ICE, and TSA who oversee the employee assistance programs (EAP). When available, we received data from the EAPs on the number of employees from these agencies who sought help about financially related matters. To understand the types of data payday lenders collect and report on borrowers we spoke with members of the payday loan industry, representatives from the major credit bureaus, and with a company that provides credit-related data that extends beyond information offered by the major credit bureaus. To understand if law enforcement employees at the three DHS components and FBI have salaries that typically fall within the range of those of the average payday loan borrower, we collected data on their salary ranges and compared them with the median income of a payday loan borrower. For more detailed information on our scope and methodology see appendix I. For the results of our salary range analysis, see appendix II. With the help of a small number of payday lenders, we also conducted a limited analysis of payday loan borrowing by employees at the four components we reviewed. Five finance companies that offer payday loans, including three of the largest, provided data on the number of borrowers (from January 1, 2010, to July 31, 2010) who identified CBP, ICE, TSA, or FBI as their employer, which we present in appendix III.[3] However, these data provide only a snapshot of the population borrowing from these lenders and cannot be used to project prevalence of payday loan use among federal employees or employees at the agencies within our scope.

To understand the alternatives to payday lending that are available to consumers needing small-dollar loans, we spoke with representatives of a number of banks and credit unions that offer small-dollar loan products. Many of these banks participated in the Federal Deposit Insurance Corporation's (FDIC) Small-Dollar Loan Pilot Program. We identified other models for small-dollar loans such as relationship lending (that is, offering loan products in the hope of establishing long-term relationships with borrowers), overdraft loans or lines of credit, partnership programs, and salary advances. We also interviewed consumer groups and trade organizations that conduct research on unbanked and underbanked populations to identify alternative models to payday lending currently in use or under development. We identified other models for small-dollar

[3] One lender provided us data for January 1, 2010–July 27, 2010.

loans offered by alternative financial services providers such as prepaid cards, car title, pawn, and installment loans.

We conducted this performance audit from June 2009 through January 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

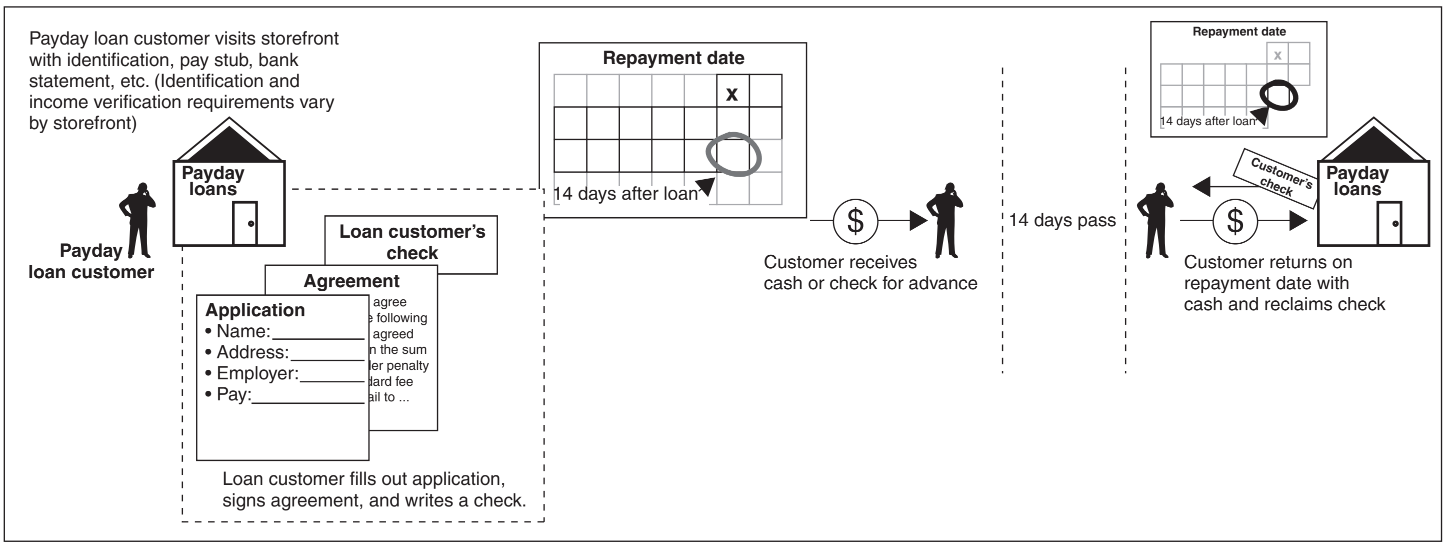
Payday lenders are one of many providers of alternative financial services—products or services that operate outside of federally insured banks, credit unions, and thrifts.[4] Because payday lenders do not usually check a borrower's credit or report to the major credit bureaus, payday loans may be an attractive option to those with poor credit history or who are concerned that a depository institution may deny them a traditional loan. According to payday lenders, they generally assume their customers have unfavorable credit histories and therefore do not typically pull credit reports as the reports would not provide much additional information for assessing the risks of lending to the customers and are expensive for the lender relative to the loan amount.

The majority of payday loan transactions take place at a payday loan storefront (see fig. 1). While the details of the process may vary according to relevant state laws, industry documents and interviews with industry officials show that a customer interested in obtaining a loan would bring identification, a pay stub, and a bank statement to the storefront. Once the customer completes the application form, industry officials told us that the loan could be approved within minutes and the borrower would write a post-dated check to the lender for the amount of the loan plus the fee. The customer signs an agreement to repay the loan, usually in 14 days, according to industry studies and representatives with whom we spoke. The customer then obtains the loan in the form of cash or check. On the day that the loan is due, the customer needs to return to the lender with cash for the loan and fee amount and reclaim the postdated check.

[4]For example, check-cashing outlets, money transmitters, car title lenders, payday loan stores, pawnshops, and rent-to-own stores all are considered providers of alternative financial services.

According to industry officials, in some states, the lender must deposit the check the borrower wrote so the borrower need not return to pick up the postdated check. Some states permit rollover of a loan for an additional fee. This would allow a borrower who still needs the cash or is unable to repay the loan in full at the time it is due to extend the loan for an additional fee. Some states allow borrowers to pay off one loan and obtain a new loan on the same day, while other states require a cooling off period before a customer can take out another loan.[5]

Figure 1: Example of a Storefront Payday Loan Transaction

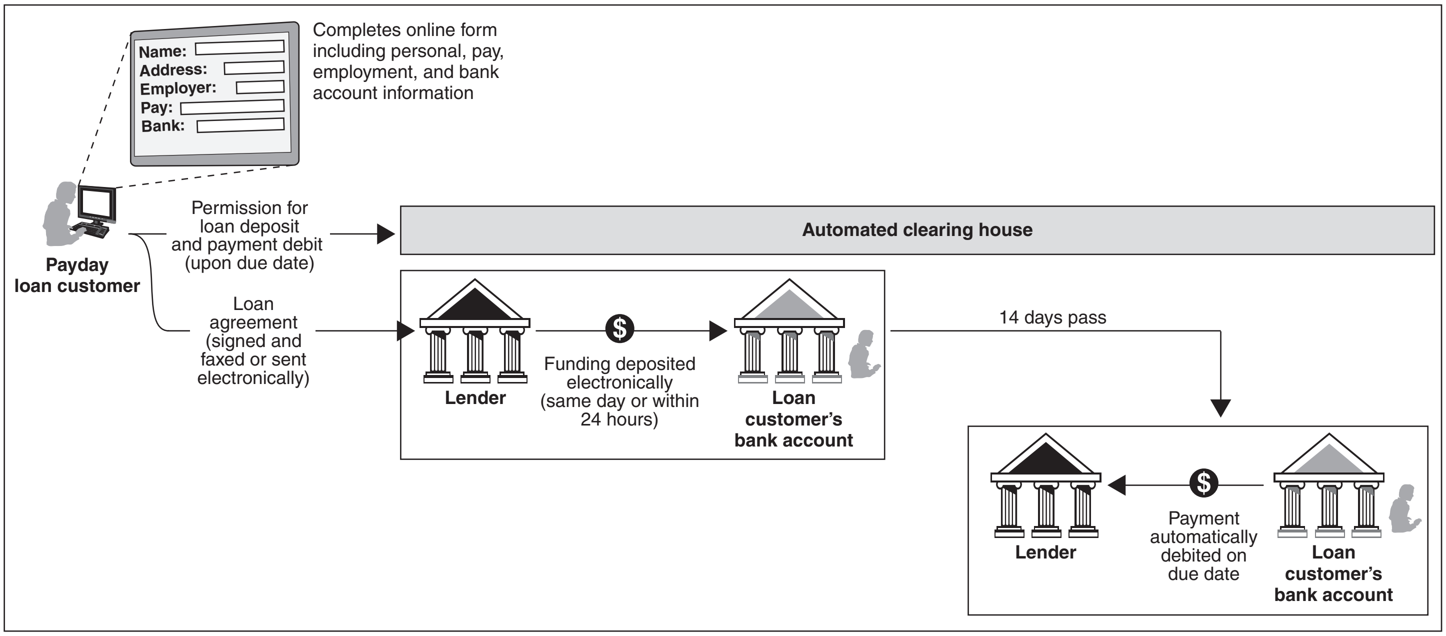


Sources: GAO (analysis); Art Explosion (images).

According to industry representatives, a growing number of lenders also offer payday loan services online (see fig. 2). The online transaction incorporates the applicant's permission for electronic payment and repayment debit.

[5]For example, Kansas allows a borrower to take up to two loans at once from the same lender, while Alabama has a restriction on the number of times that a payday loan may be rolled over. See Kan. Stat. Ann. § 16a-2-404(3); Ala. Code § 5-18A-12(b).

Figure 2: Example of an Online Payday Loan Transaction



Sources: GAO (analysis); Art Explosion (images).

Academic and industry studies have shown that many different types of people use payday loans. According to a study of 2007 survey data collected by the Federal Reserve, the median age of a payday loan borrower is 36 years old with a median household income of $32,712; in comparison, the payday loan industry reports average income ranges from $25,000 to $50,000.[6] According to our discussions with industry representatives, the recent economic downturn may have pushed this income range higher.[7] Industry representatives have told us and studies have shown, that those who use payday loans do so for a variety of

[6]Our report used an estimate of $30,892 in 2007 dollars from a study conducted by the Center for American Progress. Center for American Progress, *Who Borrows From Payday Lenders: An Analysis of Newly Available Data* (March 2009). We adjusted this number for inflation in 2010 to $32,712. The original survey results can be found at Federal Reserve Board, *Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances* (February 2009).

[7]One payday lender with whom we spoke reported seeing an increase in customers with higher incomes, some up to $70,000.

reasons, but most often use them for unexpected emergency expenses.[8] See appendix II for a comparison of the average payday loan borrower's income with the midpoint salary range of federal employees at FBI and the three DHS components we reviewed.

The National Conference of State Legislatures reported that in 2010, 40 states and the District of Columbia had established payday lending laws and industry analysts estimated that there were approximately 20,600 stores offering payday loans. The industry comprises a handful of large publicly traded payday lenders and thousands of private companies, many of them small businesses with one or two storefront locations. According to those that have studied the industry, nationally, the largest 16 companies (some privately held) own about half of the stores. Recently, the industry received attention when a report from a consumer organization disclosed that many of the larger publicly traded companies were owned in part by some of the biggest banks.[9]

Payday lenders are regulated at the state level and each state can set restrictions on the APR and fees lenders can charge. In recent years, a number of states have limited (through market-based prohibitions such as caps on fees and APRs) or prohibited payday lending.[10] At the federal level, as part of the John Warner National Defense Authorization Act for Fiscal Year 2007, the maximum APR payday lenders can charge members of the armed forces and their dependents was limited to 36 percent, including all fees and charges connected with making the loan.[11] However, federal and state regulators indicated that borrowers still can obtain payday loans online. Online lending is largely unregulated and the universe of online lenders is unknown. Payday lenders generally must abide by certain federal disclosure requirements as outlined in The Truth in Lending Act.[12]

[8] *Who Borrows From Payday Lenders* and Congressional Research Service, *Payday Loans: Federal Regulatory Initiatives* (Washington, D.C., June 7, 2006).

[9] National People's Action and Public Accountability Initiative, The Predators' Creditors: How the Biggest Banks Are Bankrolling the Payday Loan Industry (2010).

[10] According to the National Conference of State Legislatures, Georgia and the District of Columbia prohibit payday lending, while another eight states either do not have specific payday lending laws or require lenders to comply with interest rate caps on consumer loans. According to the industry officials, these conditions effectively prohibit payday lending.

[11] 10 U.S.C. § 987(b).

[12] 15 U.S.C. §1601-1667f.

The Federal Trade Commission (FTC) investigates and enforces the Truth in Lending Act and Regulation Z against payday lenders who do not make the disclosures those laws require.[13] Additionally, under the FTC Act, the FTC investigates payday lenders engaged in potentially unfair or deceptive acts or practices and takes law enforcement action when appropriate.[14] Recently, FTC has received an increased number of complaints related to debt collection practices of payday lenders. The FTC has taken law enforcement actions against some of these entities, such as its 2010 lawsuit against a payday loan operation that the FTC alleges was illegally trying to garnish consumers' wages by making false representations to consumers' employers.[15] Federal and state officials we spoke with, however, said these investigations are difficult to conduct due to limited information available on payday lenders. According to industry officials, some states require payday lenders to register and contribute information to state run databases on the loans they provide but most states do not have such requirements. The resulting lack of any comprehensive data makes it difficult to assess the true size of the industry, its various product offerings, and its business practices. The recently created federal Bureau of Consumer Financial Protection has been granted oversight responsibility for payday lenders. More specifically, payday lenders are defined as "covered persons" under the Dodd-Frank Wall Street Reform and Consumer Protection Act, which created the new bureau and gives it authority to monitor payday loan operations and require reporting of information from payday lenders. However, it is as yet unclear how this new bureau will exercise this authority.[16]

[13] 12 C.F.R. part 226.

[14] 15 U.S.C. §§ 41-58.

[15] *FTC v. LoanPointe, LLC*, No. 2:10 cv-00225 DAK (D. Utah Aug. 26, 2010) (Stipulated Final Order for Permanent Injunction and Settlement of Claims as to Defendant Mark Lofgren) (defendant did not admit any of the allegations set out in the complaint by agreeing to the settlement).

[16] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, title X, 124 Stat. 1376, 1987 (2010) established the bureau to oversee payday lenders (among other covered entities) to assure that financial products and services are fair, transparent, and competitive.

DHS Components and FBI Use a Multilayered Approach to Assess Applicants' and Employees' Financial Situations and Identify Those Who Are In Financial Distress

To assess applicants and employees suitability for employment and review certain employees for security clearances, DHS components and FBI use a multilayered approach for gathering information as part of their background investigations. This process includes assessing the financial history of an applicant or employee to identify those who may be in financial distress. As part of this assessment, DHS components and FBI review credit reports and employment history going back several years. Agencies also corroborate information collected through other sources such as personal references. The agencies periodically repeat initial investigations to ensure employees remain suitable for federal employment or a clearance, with good financial standing being one of the recurring issues of interest. While DHS components and FBI told us they are able to identify employees with financial problems through these reviews, the primary data sources used to collect financial information may not capture the use of payday loans among employees. Federal investigators and adjudicators reported that when looking at finances, they are most concerned with instances of debt and delinquency that cannot be reasonably explained or mitigated by the employee. Officials at CBP, ICE, TSA, and FBI view the use of payday loans among employees as a minimal security issue in both suitability and security clearances due to the status of a payday loan as a legally permissible financial product and relatively low rates of use observed among their employees. Our analysis of data from the payday loan industry further suggests relatively low rates of payday loan use by employees who reported employment at CBP, ICE, TSA, and FBI.

DHS Components and FBI Primarily Rely on Initial and Ongoing Suitability and Security Clearance Investigations to Learn about Applicants' or Employees' Financial Situations

DHS components and FBI collect information—relating to personal character and conduct, educational and work experience, and financial situation—about prospective or current employees through one or more of three general processes: initial suitability investigations, initial security clearance processes, and ongoing or periodic reinvestigations (for continued suitability or renewal of security clearances).[17] According to federal regulations, suitability investigations generally serve as initial investigations on all applicants for federal employment who are offered employment.[18] DHS components and FBI conduct further reviews of information collected in the initial investigation for positions that require employees to work with national security information.[19] To gain access to such information, employees must acquire and maintain a national security clearance. Security clearance investigations are conducted to the level of classification that the position requires.[20] For example, an

[17]Suitability determinations assess elements of a person's character or conduct that may impact the integrity or efficiency of the service rendered in employment in a covered federal government position. 5 C.F.R. § 731.101. Suitability is distinguished from a person's ability to fulfill the qualifications for a position, as measured by experience, education, knowledge, and skills. Applicants for covered positions are assessed by criteria OPM developed under 5 C.F.R. § 731.202(b) that constitute specific grounds for determining a person unsuitable for federal employment: "(1) misconduct or negligence in employment; (2) criminal or dishonest conduct; (3) material, intentional false statement, or deception or fraud in examination or appointment; (4) refusal to furnish testimony as required by law in regard to matters inquired of under the civil service laws, rules, regulations, and records pertinent to these matters; (5) alcohol abuse, without evidence of substantial rehabilitation, of a nature and duration that suggests that the applicant or appointee would be prevented from performing the duties of the position in question, or would constitute a direct threat to the property or safety of the applicant or appointee or others; (6) illegal use of narcotics, drugs, or other controlled substances without evidence of substantial rehabilitation; (7) knowing and willful engagement in acts or activities designed to overthrow the U.S. government by force; and (8) any statutory or regulatory bar which prevents the lawful employment of the person involved in the position in question." Although OPM developed these criteria as grounds for determining applicants unsuitable for employment, agencies exercise discretion in making such determinations and consider additional factors that include the nature of the federal position, the nature and seriousness of the conduct, its recency, the age of the person when the conduct occurred, and efforts toward rehabilitation. See 5 C.F.R. § 731.202(c).

[18]For example, applicants for certain positions such as those that are intermittent, seasonal, or temporary do not require a formal background investigation. Rather, the employing agency checks into the applicant's character or conduct as appropriate to ensure the person's suitability. 5 C.F.R. § 731.104.

[19]Exec. Order No. 12958, 60 Fed. Reg. 19825 (Apr. 17, 1995), as amended; 5 C.F.R. § 1312.23.

[20]Classification levels (confidential, secret, or top secret) correspond to the sensitivity of information that may cause serious or exceptionally grave danger to U.S. national security interests. 5 C.F.R. § 1312.4.

employee whose position is expected to have regular access to information classified at the top-secret level would require a clearance at this level. According to all officials with whom we spoke at the DHS components and FBI, suitability and security clearance investigations are multilayered processes, although they can overlap. However, final determinations on suitability and security clearances can be mutually exclusive. For example, an employee may pass the suitability investigation and later be denied a security clearance, or while passing the security clearance investigation at one agency, an employee also could be deemed unsuitable for employment in a particular position. DHS and FBI personnel or contractors conduct both suitability and security investigations. Due to the overlapping nature of suitability and national security investigations at some agencies, the same investigation may be used for both purposes.

DHS Components and FBI Use Multiple Sources to Gather Financial Information for Suitability Investigations, but the Primary Sources of Financial Information They Use May Not Identify Payday Loan Use

For the agencies we reviewed, suitability investigations generally involve verifying birth and education records and employment and military history (if applicable) and reviewing criminal and credit history. Investigations also may include interviews with the applicant's friends, colleagues, or neighbors and any current or former spouse.[21] Officials at FBI and CBP told us that they may use polygraphs to further assess the reliability of applicants' statements. In relation to the financial part of the review, suitability investigators seek to determine whether prospective employees are in good financial standing, exhibit a pattern of irresponsible financial behavior such as habitual gambling, or fail to disclose financial problems relating to assets and debts. For example, CBP investigators stated that they especially would be concerned if they found out that a border agent appeared to be living beyond his or her means based on the expected salary of a border agent. Investigators also would be interested if a border agent who passed the initial suitability investigation suddenly adopted a more affluent lifestyle as this may indicate the agent had taken money from criminal elements such as human or drug traffickers. If financial issues arise during the background investigation, applicants must mitigate the concerns of adjudicators by showing evidence of current efforts to resolve the issue. For example, an applicant could provide evidence that he or she recently received an inheritance that could account for a sudden change in lifestyle. But under certain circumstances, an individual's

[21] Additionally, OPM has delegated the authority to some agencies, including FBI, CBP, ICE, and TSA, to use in-house investigators rather than OPM personnel. Adjudicators determine the suitability based on these investigative results.

financial situation can be used as a basis for finding him or her unsuitable for federal employment. For example, an applicant who is found to be in default on federal student loans automatically would be found unsuitable for employment at FBI.[22] The more stringent threshold is in part due to the fact that the FBI requires a top-secret security clearance for all employees.

The specific sources of financial information that agencies review during suitability investigations can vary between agencies, but FBI and DHS component officials with whom we spoke told us their adjudicators use reports from one or more of the major credit reporting bureaus as the primary sources for documenting an applicant's financial situation. Credit reports typically contain a record of an applicant's payment history on outstanding debts, credit cards, auto loans, mortgages, and recent bankruptcies. If an entry on an applicant's credit report raises a concern, agency officials told us that they would follow governmentwide guidance and might conduct follow-up interviews of the applicant and persons the applicant identified as references and review other information such as civil judgments or wage garnishments against the individual. Additionally, investigators might access reports from the Financial Crimes Enforcement Network at the Department of the Treasury.[23] Some DHS components also have codes of conduct that specify established debt thresholds based on position and mission areas that may be of particular concern. For example, all law enforcement components in DHS (which include CBP, ICE, and TSA) would conduct further investigations or request further information depending on the circumstances of the case, if applicants exceeded thresholds relating to delinquent debt.

[22]OPM officials with whom we spoke explained that OPM does not regard delinquent debt as evidence of dishonest conduct.

[23]The Bank Secrecy Act (BSA), codified as 12 U.S.C. §§ 1829b, 1951-1959, 31 U.S.C. §§ 5311 et seq., requires financial institutions to report any suspicious transaction related to a possible violation of law or regulation. The Financial Crimes Enforcement Network (FinCEN) administers BSA and its implementing regulations, which direct depository institutions to file suspicious activity reports (SAR). Suspicious activity reporting is one component of broader anti-money laundering programs that depository (banks, thrifts, and credit unions) and other financial institutions implement to comply with the BSA. An institution's decision to file a SAR may be subjective and is based on its knowledge of the customer and the customer's usual banking activity. For more information, see GAO, *Bank Secrecy Act: Suspicious Activity Report Use Is Increasing, but FinCEN Needs to Further Develop and Document Its Form Revision Process*, GAO-09-226 (Washington, D.C.: Feb. 27, 2009).

However, the sources of information on which DHS components and FBI rely—such as credit reports and information collected from interviews—likely would not provide information on whether an applicant had used or currently has an outstanding payday loan. Payday lenders with which we spoke explained that they generally do not report to the major credit bureaus because of the nature of their business model. That is, payday lenders assume that their customers have low credit scores and cannot or choose not to take a loan from a traditional lender; otherwise, they would not need a payday loan. Additionally, short time frames and the recurring nature of payday loans generally make them nonreportable to the major credit bureaus. Unless some evidence of a payday loan were to be uncovered by an investigative interview with either the applicant or an applicant's reference, it is unlikely that an investigator would know of the existence of the payday loan. DHS and FBI officials with whom we spoke did not recall any instances of payday lending being reported or disclosed during suitability investigations. For example, officials at two components said that they could not recall any instances of payday lending being reported or disclosed during suitability investigations. The officials did note that they have seen an increase recently in financial problems, particularly problems with mortgages and foreclosures. Nevertheless, officials believed that investigators have been able to identify those individuals who are under serious financial distress.

The Security Clearance Process Similarly Uses Multiple Sources to Gather Financial Information, and DHS Components and FBI Focus on Situations That Cannot Be Explained by Mitigating Factors

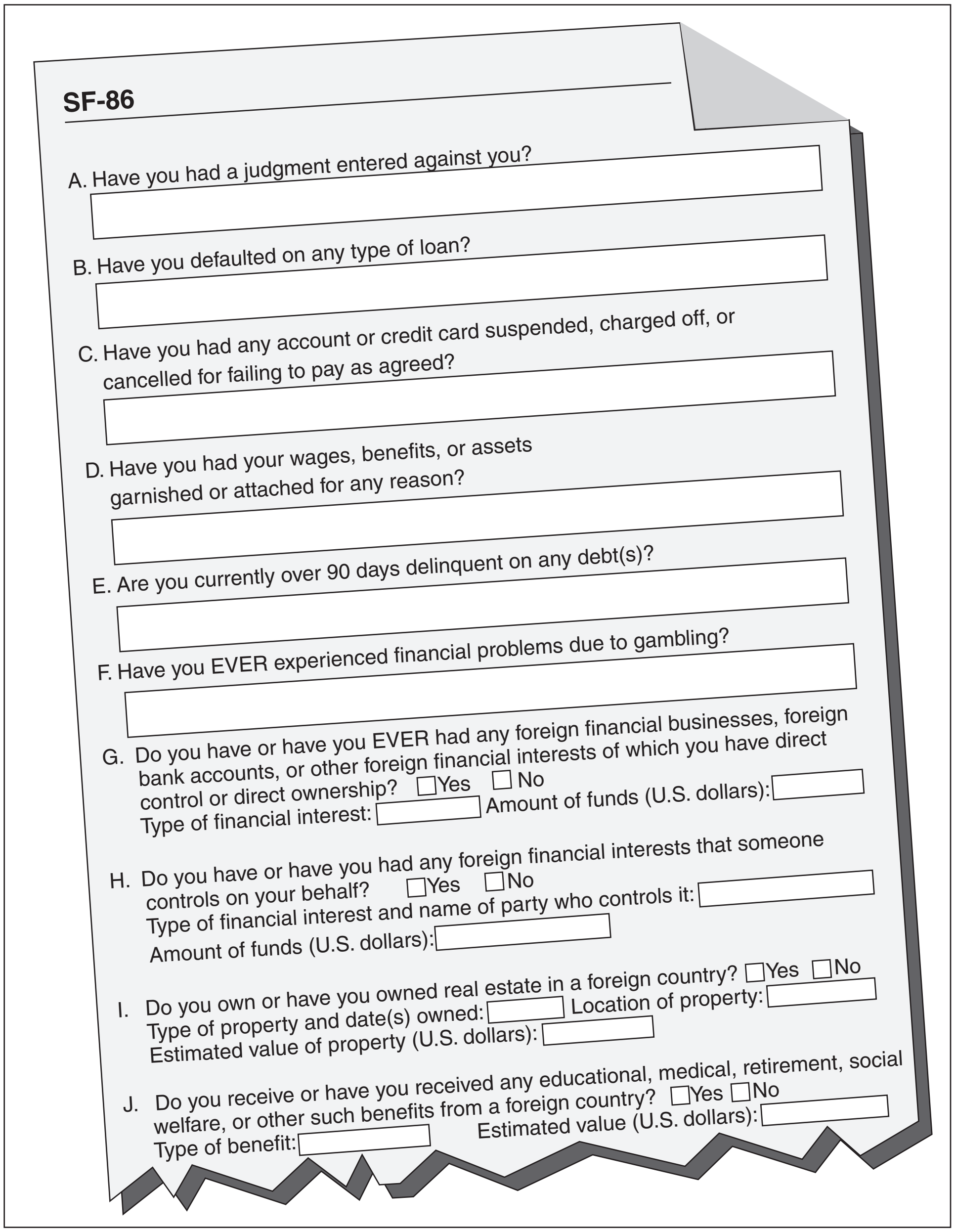
Officials we spoke with at DHS components and FBI reported that during the security clearance process their focus was on assessing employees' financial situations in light of a standard that balances derogatory information against mitigating factors. DHS components and FBI can review the same information in the security clearance process as in suitability investigations. Similar to suitability investigations, in reviewing an applicant's financial profile for a national security clearance, agencies primarily use credit reports from the three major credit reporting bureaus, further supported with follow-up interviews with personal references and the applicants themselves.

As part of the security clearance process, applicants also must fill out OPM Standard Form 86 (SF-86).[24] An applicant must report all current financial obligations, debts, and liabilities including student loans, auto loans, and unsecured debts as well as the applicant's payment history, including all current delinquencies of 90 days and all debts in the past 7

[24]The SF-86 is also known as the Questionnaire for National Security Positions.

years that had been delinquent for 180 days or more. Some disclosures must go beyond 7 years, for example, employees who are undergoing more extensive background investigations must extend disclosures of criminal histories for the past 10 years, and all employees must disclose any past gambling problems. See figure 3 for examples of the questions on the form. However, it is unlikely that the SF-86 would capture payday lending unless employees had a current payday loan at the time they completed the SF-86. Due to the short-term nature of a payday loan (typically 14 days), unless applicants recently had taken out or rolled over a payday loan at the time they were filling out the SF-86, they would not be required to disclose it at the time. A rolled-over payday loan might not be considered a delinquent debt if it was structured as a new loan created to pay off the previous payday loan.

Figure 3: Sample SF-86 Financial Questions



Source: Examples of questions from Standard Form 86 Questionnaire for National Security Positions, revised July 2008.

Furthermore, DHS components we reviewed (CBP, ICE, and TSA) reported that they have set discrete standards and reporting requirements relating to certain positions and clearances or types of debt. For example, one TSA security official stated that once employees have active security clearances, they must report any substantial changes to their finances or any debts on which they are 120 days or more past due. The three DHS components that we reviewed (CBP, ICE, and TSA) set an adjudicative threshold for individuals required to maintain a higher clearance.[25]

Although DHS components and FBI may consider much of the same financial information for suitability investigations and security clearances, the security clearance process explicitly balances financial liabilities against mitigating factors in its assessment framework.[26] According to governmentwide guidelines titled *Adjudicative Guidelines for Determining Eligibility for Access to Classified Information*, in processing security clearances, adjudicators apply a subjective "whole person standard" that considers multiple factors.[27] According to DHS and FBI, both agencies use governmentwide guidelines for processing national security clearance applications. When adjudicating an applicant's financial profile, federal agencies must consider the five derogatory financial factors in Guideline F (Financial Considerations), which are

1. A history of not meeting financial obligations.

2. Deceptive or illegal financial practices such as embezzlement, employee theft, check fraud, income tax evasion, expense account fraud, filing deceptive loan statements, and other intentional financial breaches of trust.

3. Inability or unwillingness to satisfy debts.

4. Unexplained affluence.

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[25]This debt threshold is established under Executive Order No. 12968, 60 Fed. Reg. 40245 (Aug. 2, 1995).

[26]GAO, *DOD Personnel Clearances: Comprehensive Timeliness Reporting, Complete Clearance Documentation, and Quality Measures Are Needed to Further Improve the Clearance Process*, GAO-09-400 (Washington, D.C.: May 19, 2009).

[27]There are 13 sets of guidelines for adjudicators to consider in processing security clearances: Guideline A–allegiance to the United States; Guideline B–foreign influence; Guideline C–foreign preference; Guideline D–sexual behavior; Guideline E–personal conduct; Guideline F–financial considerations; Guideline G–alcohol consumption; Guideline H–drug involvement; Guideline I–emotional, mental, and personality disorders; Guideline J–criminal conduct; Guideline K–security violations; Guideline L–outside activities; and Guideline M–misuse of information technology systems. 32 C.F.R. part 147.

5. Financial problems that are linked to drug abuse, alcoholism, gambling problems, or other issues of security concern.

The presence of derogatory factors can be mitigated or favorably addressed by any of the following factors:

1. The behavior was not recent.

2. It was an isolated incident.

3. The conditions that resulted in the behavior were largely beyond the person's control.

4. The person has received or is receiving counseling for the problem and there are clear indications that the problem is being resolved, or under control.

5. Affluence resulted from a legal source.

6. The individual initiated a good-faith effort to repay overdue creditors or otherwise resolve debts.

DHS components we reviewed and FBI stated that in their interpretation of Guideline F, they were most concerned with delinquencies, bankruptcies, defaults, wage garnishment, and other debt collection actions that could not be explained by one of the mitigating factors. Two components (CBP and FBI), interpreted this guidance and other, nonfinancial factors (established by Executive Order No. 12968) to permit them to adjudicate each application on a case-by-case basis, with CBP indicating that any derogatory factor to surface could be mitigated by the employee using the whole person standard.

Finally, we asked DHS components and FBI how many applicants or employees were denied security clearances because of financial reasons. While not all the components with which we spoke track this information, they reported anecdotally they believed the number to be small.

DHS Components and FBI Conduct Periodic Reinvestigations and Some Employees Also File Annual Financial Disclosure Forms, but Information Collected Generally Would Not Identify Payday Lending

Officials with whom we spoke at DHS and FBI stated that the agencies periodically reinvestigate employees for both suitability and security clearances and some employees also may be required to file additional annual financial disclosures. For all federal employees, security clearance reinvestigations typically take place in 5- or 15-year intervals and follow the same criteria and methods as the initial investigations with the exception of reduced reporting time frames consistent with the date of the last reinvestigation. For instance, reinvestigations rely heavily on recent credit reports, which likely would not capture payday lending. For those employees whose positions require an active security clearance, agencies conduct reinvestigations at intervals corresponding with the employee's level of clearance. Reinvestigations occur every 5 years for top secret, 10 for secret, and 15 for confidential clearances. Employees must update the SF-86 from their last investigation. One senior TSA security official stated that if they became aware of an employee using a payday loan, it would not be cause for a reinvestigation. They might pull a credit report to make sure there were no other financial issues, but use of a payday loan alone would not lead to reinvestigation.

DHS components and FBI also can assess the financial well-being of some employees through the annual financial disclosure process. The Office of Government Ethics issues the Confidential Financial Disclosure Report (forms OGE-450 and OGE-278) that qualifying executive branch employees must fill out annually to disclose outside income, assets, and outstanding liabilities.[28] Depending on position and pay grade, some employees must file the annual financial disclosure form that may capture additional

[28]All executive branch employees that are currently employed in agency-designated positions are required to file the OGE-450. Executive branch employees who occupy those positions above GS-15 are required to file the OGE-278.

financial information.[29] For example, OGE requires filers to disclose all assets held for investment with a value exceeding $1,000 or any asset that produced more than $200 in income during the previous year. With certain exceptions, OGE-278 incumbent and termination filers are also required to report all transactions that occurred in the past year that exceeded $1,000. In contrast, the SF-86 requires the applicant to list only assets that are considered foreign financial interests, and does not require the filer to report any asset transactions. The purpose of the forms is to assist employees and their agencies in avoiding conflicts of interest between official duties and private financial interests or affiliations. Because this annual disclosure requires reporting debts of more than $10,000, it is unlikely that an employee would be required to report a payday loan because the average payday loan is lower than the reporting threshold.

At their discretion, DHS components and FBI may choose to employ additional methods to ensure the integrity of their employees including polygraph examinations, more frequent reinvestigations, and access to other unspecified sources of information. Use of polygraph examinations varied at the components with which we spoke. FBI regularly uses them in investigations and reinvestigations, CBP uses them as a supporting investigative tool for certain positions, and ICE and TSA do not use them. All DHS components and FBI told us that they could reinvestigate employees at any time if financial issues became known or they were concerned about an employee's financial well-being.

[29]According to 5 C.F.R. § 2634.904, filers generally include: (1) each officer or employee in the executive branch whose position is classified at GS-15 or below of the General Schedule; and each officer or employee in any other position determined by the designated agency ethics official to be of equal classification if: (i) the agency concludes that the duties and responsibilities of the employee's position require that employee to participate personally and substantially through decision or the exercise of significant judgment, and without substantial supervision and review, in taking a government action regarding (A) contracting or procurement; (B) administering or monitoring grants, subsidies, licenses, or other federally conferred financial or operational benefits; (C) regulating or auditing any nonfederal entity; or (D) other activities in which the final decision or action will have a direct and substantial economic effect on the interests of any nonfederal entity; or (ii) the agency concludes that the duties and responsibilities of the employee's position require the employee to file such a report to avoid involvement in a real or apparent conflict of interest, and to carry out the purposes behind any statute, Executive Order, rule, or regulation applicable to or administered by the employee. Positions which may be subject to a reporting requirement under this subparagraph include those with duties which involve investigating or prosecuting violations of criminal or civil law.

DHS and FBI Consider Payday Loan Use among Employees to Be a Minimal Security Issue Affecting Suitability and Clearances

We obtained CBP, ICE, TSA, and FBI perspectives about employee use of payday loans as it relates to suitability and national security clearance determinations. All of the officials with whom we spoke stated that they were not aware of significant payday loan use, nor were they concerned with it as a security issue. For instance, FBI officials said that while they have become aware during the suitability or security clearance processes of employee use of other high-interest loans, they could not recall any instances that discovered the use of payday loans. TSA and ICE officials said that they did not regard payday loans as a security issue. In our discussions with CBP, ICE, TSA, and FBI, officials pointed out that under current law, having a payday loan is not illegal, but knowledge that an employee had used such a loan might raise concerns that an employee was in trouble financially.

Although payday lending is not being reported regularly to the major credit bureaus and does not show up on credit reports, DHS components and FBI felt confident that they captured an adequate amount of both applicants' and current employees' financial information to make sound determinations of suitability or grant security clearances. FBI officials explained that although the presence of a payday loan might indicate that the individual was overextended financially, they felt the existing background investigation process would capture information needed to assess the individual's overall financial situation. CBP officials explained that their investigations captured the majority of information on applicants, and they felt the current process was sufficient overall. CBP and ICE acknowledged that reinvestigations might miss instances of financial distress because of the time gaps between investigations. But CBP officials stated that while they did not completely capture such instances, current policies and procedures struck a reasonable balance between agency needs and available resources for investigations and adjudications. Furthermore, CBP, ICE, and TSA asserted that a suitability review followed by a security clearance review represented a multilayered approach—if derogatory financial information did not come to light in the suitability review, it could be identified when information was reviewed for the security clearance.[30] DHS components and FBI consistently described the suitability and security clearance processes as tiered approaches (through administratively designed redundancies in

[30]As authorized by title III of the Intelligence Reform and Terrorism Prevention Act of 2004, the President's security clearance oversight working group has been considering the security clearance and reinvestigation process. 50 U.S.C. § 435b.

investigative inquiries and methods) for uncovering financial and other information on their employees. For example, ICE described it as a "two-pronged approach" at determining whether an employee should be entrusted with a national security clearance or continued employment at ICE.

DHS components and FBI officials emphasized that they would view the presence of a payday loan on an applicant's or employee's record in the context of the "whole person standard." That is, while certain types of information about an individual's financial situation might raise concerns, the fact that an applicant or employee had taken out a payday loan would not be an automatic disqualifier to employment or a clearance. In looking at an applicant or employee's financial history, agencies weighed an individual's explanation for debts or risky financial behavior against the extent, circumstances, and severity of the debts or risky financial behavior. DHS components and FBI officials further stressed that they were not as concerned with a single instance of debt or an individual using a payday loan one time as they were with recurring debts or risky financial behaviors, or how payday loans might contribute to such patterns. For instance, a habitual gambler or drug user might need cash on short notice and have to resort to taking out a payday loan. However, DHS components and FBI officials stressed that the existence of a payday loan, if it could be identified in the credit report or through other sources, is not currently considered a determining factor or a disqualifier. Payday loans are legal financial services when obtained online or at a storefront in a state where they are not prohibited. Any delinquent debt and the circumstances surrounding the delinquency would be more of a determining factor than a payday loan itself.

Furthermore, all the agency officials with whom we spoke stated that they have resources available for employees who need help with a number of issues, including financial matters. Credit counseling and other services are available through EAPs.[31] These programs provide confidential help to employees and work with them to address problems. Officials at CBP, ICE, TSA, and FBI with whom we spoke said that they may suggest or encourage employees to speak with EAP counselors if they experienced

[31]All federal agencies provide EAPs. Basic EAP services include free, voluntary, short-term counseling and referrals for various issues affecting employees' well-being, such as alcohol and other substance abuse, stress, grief, family problems, and psychological disorders. EAP counselors also work with managers and supervisors to help address employee and organizational challenges and needs.

financial or other difficulties. For example, FBI investigators explained that contacting the agency's EAP for financial counseling generally was considered evidence of an employee's efforts to resolve financial issues. Since EAP counseling is confidential, officials were unable to tell us if employees specifically sought help for financial problems relating to payday loans but said that employees did seek help for a number of financial issues related to divorce, credit card debt, and over extension on mortgages. Officials from the FBI EAP said that it tracks reasons for employees seeking EAP services; however, the EAP does not collect and retain information at a level of detail that would allow them to identify individuals who use payday lending services. The FBI's EAP providers reported anecdotally about four or five cases annually of self-reported payday loan use, while case files showed that 443 employees spoke with EAP counselors regarding financial issues in 2009. DHS components were also able to provide general information on the number of employees who sought help for financial matters including credit card debt, mortgage issues, and medical expenses. For example, CBP reported that in fiscal year 2009, 29 employees or family members of employees contacted the EAP about financial concerns. TSA reported that payday lending was not an issue raised or documented during EAP counseling but there were hundreds of employees who spoke with counselors regarding other financial issues. EAP counselors we spoke with reiterated that few employees raised the use of payday loans as an issue during counseling; however, when the issue did come up, counselors said that employees tended to be in significant financial distress. Additionally, FBI officials stated that the agency has a Post-Adjudication Risk Management Program for persons who may pose a risk to the agency on account of financial considerations (as determined by FBI adjudicating officers). These employees are required to enter the program where they are monitored for improvements in negative patterns of behavior.

Data Suggest Relatively Low Rates of Use of Payday Loans among Selected Federal Employees

While payday lending to federal employees does occur, data we obtained from the four agencies we reviewed on the salary levels of their employees suggest that these federal employees do not match the income profile of the average payday loan borrower. As described previously, one reported median household income of a payday loan borrower is estimated to be around $32,712. Salaries at DHS components and the FBI generally are higher than this. Employees at these components have salaries that range from approximately $42,000 to $155,000, with most making at least $60,000 and some law enforcement positions at ICE and FBI in particular making significantly more (see appendix II for more information). Furthermore, federal law enforcement employees receive additional Law Enforcement

Availability Pay, which is a type of premium pay for federal law enforcement officers who are criminal investigators.[32] The salary ranges listed above and in appendix II do not account for Law Enforcement Availability Pay. Additionally, federal employees receive benefits such as health insurance and disability insurance, which may provide an extra financial cushion in emergency situations. While this does not preclude these individuals from using payday loans, it suggests that they may not be the typical payday loan customer. Additionally, as discussed in the next section, federal employees may have other options available to them if they need financial assistance or short-term, small-dollar loans.

Similarly, data we obtained from the payday loan industry appear to support the DHS components' and FBI's low level of concern with regard to use of this product among employees (see app. III). The five payday lenders that provided data to us all reported that they made loans to people who identified their employer as one of the four components we reviewed, but the employees using the loans constituted a small percentage of the agencies' total workforce (law enforcement and nonlaw enforcement). During the period we analyzed, individuals receiving payday loans represented from 0.15 to 1.57 percent of the employees at each of the four agencies. However, these data are not representative of all loans borrowed by employees at these agencies during this time period as they only include information from five lenders.

Small-Dollar Alternatives to Payday Loans Are Limited in Scope but Recent Actions May Encourage Broader Availability

Depository institutions, employers, and nonprofit organizations have developed various small-dollar loan models, including lending through the workplace and partnerships with nonprofits. Some institutions offer products that may serve as alternatives to payday loans—mimicking some of the terms and conditions of these transactions but generally offering lower interest rates—while others use the small-dollar loan products to establish long-term relationships with borrowers or meet a need for short-term credit in their community. Some small-dollar loan options we identified are available exclusively to federal employees or other specific populations, while other institutions offer their small-dollar loan products to the general public. Despite the variety of small-dollar loan products

[32] Due to the nature of their work, criminal investigators are required to work, or be available to work, substantial amounts of "unscheduled duty." Availability pay is generally an entitlement that an agency must provide if the required conditions are met. By law, availability pay is generally fixed at 25 percent of a criminal investigator's rate of basic pay. 5 U.S.C. § 5545a(h); 5 CFR § 550.185

available, the number of institutions offering such products still is relatively small. Officials from a number of depository institutions with whom we spoke cited challenges to increasing the availability of small-dollar loans, including credit risk and concerns about the profitability of the product. However, recent actions such as changes in legislation and efforts to increase interest rates and ease some regulatory restrictions could prove useful in increasing the number of institutions offering small-dollar loan options to consumers.

Workplace Lending Has Provided Some Employees with Small-Dollar Loan Options

Some Federal Employees Have Access to Small-Dollar Loan Options in Limited Situations

According to OPM and federal regulators, some federal employees who face financial difficulties have small-dollar loan options, but we found they are relatively limited in use and scope. The federal government offers employees an option for obtaining loans in certain situations. Through the Thrift Savings Plan (TSP), current federal employees (or members of the uniformed services) can obtain a general purpose loan (for any reason with no documentation required) if they have at least $1,000 of their own contributions and earnings in a plan account.[33] The minimum TSP loan amount is $1,000 and the repayment term for the general purpose loan is from 1 to 5 years (repayment is through payroll deduction).[34] There is a $50 application fee and turnaround time varies from 3 to 8 business days to several weeks depending upon the application process (electronic or

[33]TSP is a retirement savings and investment plan for federal employees and uniformed services, which is administered by the Federal Retirement Thrift Investment Board. TSP resembles private-sector 401(k) pension plans in that both allow employees to contribute a portion of their current compensation through payroll salary deductions and invest their account balances among a menu of investment options selected by the employer.

[34]In addition to the TSP general purpose loan, current federal employees (including employees in a nonpay status) may be eligible to apply for a TSP financial hardship in-service withdrawal (employees are limited to only one financial hardship withdrawal in a 6-month period). The financial hardship in-service withdrawal is only available if financial need results from at least one of the four following conditions: recurring negative monthly cash flow; medical expenses (including household improvements needed for medical care) that have not yet been paid and that are not covered by insurance; personal casualty loss(es) that have not yet been paid and that are not covered by insurance; or legal expenses (such as attorneys' fees and court costs that have not yet been paid for separation or divorce). Employees may withdraw only their own contributions and any earnings those contributions have accrued (minimum withdrawal is $1,000).

paper).[35] Employee participation in the TSP is voluntary; thus, not all federal employees would have access to this option. Additionally, the minimum TSP loan amount ($1,000) may exceed employees' short-term credit needs as the typical payday loan transaction is $100–500. Further, turnaround time is important for borrowers who need short-term credit; therefore, this option may not be viable in situations when an employee needs funds immediately. According to the Federal Retirement Thrift Investment Board, TSP participants had more than 805,000 outstanding loans as of July 2010.

Federal employees who are facing economic hardships due to an unexpected emergency (for example, death in the employee's immediate family, loss of income, or divorce) also may be eligible to apply for a loan or a grant (grants are infrequently made and only in the most extreme circumstances) through the Federal Employee Education and Assistance Fund, a nonprofit organization. This organization provides no-interest loans of up to $1,000 (applicants are required to provide verification of financial hardship). Loans generally are processed within one business day and there is no credit check. Payments are made directly to the creditor(s). Loans generally are repaid within 1 year through payroll allotment administered by the employee's payroll service. According to the Federal Employee Education and Assistance Fund, due to current economic conditions, loan volume has nearly doubled in the last 2 years from 367 loans in 2009 totaling $250,801 to 772 loans totaling $474,714 in 2010. Since the program's inception in 1987, the organization has made more than 5,900 loans totaling $3,587,987 as of December 2010.

We also identified two federal agencies with in-house credit unions that offer small-dollar loans to employees. Representatives from the two federal credit unions reported that they identified employees' need for short-term credit upon reviewing members' automated clearing house activity.[36] For example, one credit union recognized that some of its members were obtaining multiple payday loans during the same pay

[35]The interest rate for the general purpose loan is the G Fund rate at the time the loan application is processed—2.375 percent as of December 24, 2010. This rate is fixed for the life of the loan. Although TSP loan interest is not tax-deductible, all of the interest goes back into the employee's TSP account.

[36]The automatic clearing house (ACH) is an electronic batch processing system by which payment orders are exchanged among banks. Representatives from two of the credit unions with which we spoke reported that they can identify the names of major payday lenders on members' ACH transactions.

period through their account activity. In response, the credit union partnered with a nonprofit organization that had an existing small-dollar loan program to offer members an alternative to payday loans. Applicants must be credit union members (for at least 120 days), have a job or retirement income, and have direct deposit. Loan amounts are $250 or $500, and the APR is approximately 18 percent. The approval process generally takes about an hour. Members pay an annual fee to join the program and must qualify for the program annually.[37] Members are permitted one outstanding loan at a time; however, they can take out subsequent loans up to their loan limit without additional fees or paperwork after the initial loan is paid in full. The ability to obtain subsequent loans may provide eligible employees with regular access to short-term credit. The program also includes a mandatory savings component that is set aside and held during the duration of the loan ($25 for a $250 loan and $50 for a $500 loan). The representative reported that most members do not withdraw the money that is set aside for the savings component after the loan is paid in full because they intend to take out another loan soon thereafter. According to the representative, the credit union made 2,120 loans in 2009 and 1,090 in 2010 (as of June).

Finally, some federal employees may be eligible for pay advances. OPM delegated authority to individual agencies to provide pay advances in limited situations (for example, for newly appointed employees no later than 60 days after their appointment, or during situations in which employees have received an order to evacuate, provided that advance pay is required to help employees defray immediate expenses incidental to the evacuation).[38] However, these provisions do not provide employees with regular or easy access to financial assistance for routine expenses, a common reason consumers obtain payday loans. Further, according to OPM officials, agencies do not report use of pay advance authority to OPM. Agency officials at DHS confirmed that the agency does not have a formal policy for advancing pay and has not provided advance pay to its employees.

[37]The nonprofit uses the annual fees that credit unions participating in this program collect to fund a loan loss reserve that reimburses credit unions for 50 percent of any loan losses.

[38]5 U.S.C. § 5522, 5524a; 5 C.F.R. §§ 550.203, 505.403. OPM officials reported that DOD also has agency-specific regulations for advancing pay to military employees that relocate in certain situations. Financial Management Regulation 7000.14-R, Volume 7A, Chapter 32.

Some Private-Sector and Other Governmental Employers Also Have Offered or Developed Workplace Lending Options

In addition to the small-dollar loan options for federal employees outlined above, we identified two workplace lending models that are in use or being developed—depository-employer partnerships and payroll deduction. That is, employees can obtain a loan indirectly through an employer that has a partnership with a depository institution or directly through an employer that offers a loan as an employee benefit. Officials from a few depository institutions with whom we spoke reported that they formed partnerships with employers to offer employees an alternative to payday loans. For example, a state employee assistance fund partnered with a state credit union to form a loan program in July 2009 after increases in emergency grant applications to the fund raised concerns about employees' financial stability. The loan is available to credit union members who are salaried state employees (employed at least 12 months and with no current disciplinary actions). Applicants must undergo a credit check and cannot have adverse credit history such as bankruptcy. Applicants also must complete an online financial education module and establish direct deposit with the credit union. Loan amounts range from $100 to $500 (in $100 increments) and the APR is 24.99 percent with a 6-month repayment term.

The second workplace lending model—payroll deduction—allows employers to offer a small-dollar loan or line of credit that employees repay in installments through payroll. We identified at least two companies that have developed technology platforms that can interface with payroll systems to offer small-dollar loans. Companies that offer this product report that automation streamlines the underwriting process, which reduces loan origination fees. For example, a representative from one company reported that its technology platform allows employers to establish standard underwriting criteria such as employment history, income requirements, and loan options. The automated system verifies that an applicant meets the employer's loan eligibility criteria, which eliminates overall underwriting costs. Further, the payroll deduction model provides direct access to employee payroll, thereby reducing the risk of loan default. We discuss how concerns about profitability and credit risk may affect the availability of small-dollar alternatives to payday loans in more detail later in this report.

Some Community and Regional Depository Institutions Offer a Range of Small-dollar, Short-term Loan Products but They Have Not Been Widely Available

Some community and regional depository institutions have developed a range of different products and mechanisms to offer consumers short-term credit; however, many of these products are not widely available or have eligibility restrictions. According to industry studies, small-dollar loans generally range from $100 to $500. But representatives with whom we spoke from depository institutions that participated in FDIC's Small-Dollar Loan Pilot Program reported that their small-dollar loans ranged from $50 to $3,000.[39] Depository institution representatives reported that their loans, unlike payday loans, have no balloon payments and repayment terms range from 1 to 24 months.[40] Although small-dollar loan products that depository institutions offer vary with regard to conditions, terms, and availability, they generally offer more favorable terms than payday loans. However, all of the depository institution officials with whom we spoke said that as regional or community institutions, they provided limited geographical, and thus, consumer availability for small dollar loans. In addition, some depository institutions require that consumers meet eligibility criteria, including having an established relationship with the institution, minimum income level, credit history, ability to repay, and mandatory financial education or savings components. Limitations of some small-dollar loan programs (for example, eligibility criteria) may hinder their usage. For instance, one bank that participated in the FDIC pilot reported that it offered a small-dollar loan product as an alternative to payday loans at four of its branches on military installations; however, the bank did not issue any loans despite interest in the product as none of the applicants met loan eligibility requirements.[41] Specifically, a representative reported that approximately 20 people inquired about the bank's small-dollar loan product during the 2 years it was offered but all of the applicants had a credit history which made them ineligible—applicants were required to have no previous credit history to qualify for a small-

[39]In February 2008, FDIC began a 2-year pilot project to review affordable and responsible small-dollar loan programs in financial institutions. The pilot was designed to illustrate how banks profitably could offer affordable small-dollar loans as an alternative to high-cost credit products, such as payday loans and fee-based overdraft protection. The pilot tracked two types of loans—small-dollar loans of $1,000 or less and nearly small-dollar loans from $1,000 to $2,500—however, one pilot participant reported making loans up to $3,000. We discuss the pilot in more detail later in this report.

[40]A balloon payment is the final installment of a loan to be paid in an amount that is disproportionately larger than the regular installment.

[41]The small-dollar loan product was available exclusively to active members of the military. Loans amount ranged from $500 to $1,000, and there was a $50 application fee. The APR varied between 18–22 percent, and the repayment term was 6–12 months.

dollar loan. The representative reported that the bank did not continue to offer its small-dollar product after the FDIC pilot concluded, but was exploring ways to revise underwriting standards to make the product more appealing to borrowers. FDIC reported that several other banks that participated in the pilot were actively serving the military population. Finally, some depository institutions offer a small-dollar loan product for a very specific purpose. For example, one institution offered a small-dollar loan product exclusively to immigrants to cover the cost of citizenship application fees.

Some Depository Institutions Offer Salary Advances as an Alternative to Payday Loans

Some depository institutions offer checking account holders with direct deposit the ability to access short-term, small-dollar loans or lines of credit for a fee. Customers are required to request the advance, which is repaid through direct deposit. For example, according to the president of one of the credit unions with whom we spoke, his institution has issued more than $5 million in salary advance loans over the past 10 years and they were the most profitable loan product in the institution's portfolio. Borrowers must be credit union members to qualify for the small-dollar loan product. Loan amounts range from $50 to $500, and the APR is 12 percent with a 12-month repayment period. There is a forced savings component, which diverts 5 percent of the total loan into a savings account where it is held as long as the pay advance loan is active under the member's name. If a member obtains consecutive pay advance loans, the savings account slowly builds and collects interest. If a member's savings account hits the maximum pay advance amount of $500, the credit union then converts the pay advance loan to a secured loan and can offer the borrower a lower interest rate.

Challenges to Increasing Availability of Small-Dollar Loans May Include Credit Risk and Unprofitability

A few representatives from the depository institutions and nonprofit organizations we contacted cited credit risk to depository institutions as a challenge in offering a small-dollar loan product. Generally, small-dollar loans, which are unsecured loans because borrowers are not required to provide collateral, are viewed as a higher credit risk than secured loans. Additionally, a majority of the depository institutions we reviewed have a streamlined underwriting process for their small-dollar loan products. That is, depository institution officials told us that small-dollar loan applicants generally had to provide less personal information for small-dollar loans than for traditional, secured loans, which may contribute to higher loan losses.

Overall, we found that delinquency rates, which can serve as an indicator of credit risk, varied among the depository institutions, according to officials with whom we spoke.[42] Specifically, delinquency rates for their small-dollar loan product ranged from under 3 percent to approximately 13 percent. In comparison, according to the Federal Reserve delinquency rates for all consumer loans (insured U.S.-chartered commercial banks) ranged from 4.61 to 4.82 percent in 2009.[43] Prior to the financial crisis in 2007, the Federal Reserve reported that delinquency rates for all consumer loans ranged from 2.77 to 2.97 percent.

FDIC reported that the delinquency rates for small-dollar loans made during its small-dollar loan pilot were relatively stable at about 9 percent for much of 2009, but climbed to 11 percent in the fourth quarter of 2009 which it largely attributed to adverse economic conditions. FDIC noted that although delinquency rates for small-dollar loans made during the pilot were much higher than for other types of general unsecured loans to individuals, charge-off ratios (from 4.3 to 6.6 percent) generally were in line with industry averages for unsecured loans to individuals for 2009 (from 4.9 to 5.4 percent).[44] Overall, FDIC concluded that pilot loan performance statistics indicated that small-dollar loan borrowers might have had more difficulty paying loans on time but had a similar default risk to those in the general borrower population. Furthermore, a representative from a nonprofit with whom we spoke reported that the loan loss ratio, another indicator of credit risk, for the nonprofit's small-dollar loan program recently was 5–6 percent—1 percent lower than when the program first started. The program initially offered the loan to current members already using payday loans (the credit unions had recognized that current members were using payday loans by reviewing their ACH activity) and therefore were more of a credit risk.[45] The program then expanded to all credit union members and the loan-loss ratio decreased. While not directly comparable, the loan loss reported by publicly traded

[42]Delinquent loans and leases are those past due 30 days or more and still accruing interest as well as those in nonaccrual status.

[43]FDIC reported that analysis it conducted found delinquency rates for general unsecured loans to individuals were relatively stable at 2.5 percent for 2009.

[44]Charge-offs are the value of loans and leases removed from the accounting books and charged against loss reserves. Charge-off rates are calculated on an annualized basis and net of recoveries.

[45]The loan loss ratio (generally, pretax income and loan loss provisions divided by net charge-offs) is calculated to determine the rate of loan losses for a specific period. It provides an indication of the volume of loan losses in a period relative to the average portfolio outstanding.

payday loan companies was 20.4 percent of revenue in 2009 (compared to 23.2 percent in 2008).[46]

Depository institutions commonly offer more expensive small-dollar loan options, such as overdraft loans or lines of credit that consumers often use as a source of short-term credit. For a fee, the depository institution will cover transactions that exceed the available balance of an account. The depository institution collects the funds, including all associated fees, from the customer's next deposit into the account. However, consumers must have an established account with the depository institution to qualify for this product, and the cost for this short-term credit can be relatively high.

According to an FDIC study of bank overdraft programs, the median amounts of a point-of-sale (POS) debit card transaction, automated teller machine (ATM) withdrawal, and a check that resulted in a nonsufficient funds (NSF) transaction were $20, $60, and $66, respectively, and the median overdraft fee was $27 per transaction.[47] As detailed in table 1, many of these overdraft fees tend to have higher APRs when compared with a payday loan and applying a 14-day repayment term.[48] Quicker repayment of the overdraft amount would result in higher APRs, and slower repayment would result in lower APRs.[49]

[46]Stephens Inc., *Payday Loan Industry: Entering Early Stage of a Recovery; Expect Above Normal Growth* (April 2010).

[47]In 2006 FDIC began a two-part study to gather empirical data on the types, characteristics, and use of overdraft programs operated by FDIC-supervised banks. Data and information for FDIC's study were gathered through a survey of a sample of institutions representing 1,171 FDIC-supervised banks, and a separate data request of customer account and transaction-level data from a smaller set of 39 institutions. FDIC issued the formal results of its study in November 2008. See FDIC, *Study of Bank Overdraft Programs* (Washington, D.C., November 2008).

[48]Truth in Lending Act (TILA) and its implementing regulation, Regulation Z, require certain product information to be included in disclosures to borrowers for many types of credit products, including payday loans. (TILA is codified at 15 U.S.C. § 1601-1667f and Regulation Z can be found at 12 C.F.R. part 226). The payday lending industry has debated whether the APR is the appropriate way to calculate payday loan fees. The industry argues that a payday loan is a short-term loan (generally repaid within 2 weeks); therefore, calculating the fees as an annual rate of interest (the APR) is not an accurate reflection of costs.

[49]*Study of Bank Overdraft Programs*.

Table 1: Comparison of Costs to Consumers of Obtaining a Payday Loan versus Bank Overdraft Fees, Based on a 14-Day Term as of November 2008

Product	Median transaction Size	Median fee	APR
Payday loan	$361	$53	391%
Point-of-sale and debit overdraft	20	27	3,520
ATM overdraft	60	27	1,173
NSF check	66	27	1,067

Sources: GAO analysis of FDIC data and data from the largest nonbank providers of payday cash advance services in the United States.

Unlike other small-dollar loan options discussed above, overdraft fees are a significant source of fee income for depository institutions. According to an FDIC survey of 462 FDIC-supervised banks, the banks earned an estimated $1.97 billion in NSF-related fees in 2006, representing 74 percent of the $2.66 billion in service charges on deposit accounts reported by these banks in their call reports.[50] As such, there could be a disincentive for depository institutions to offer small-dollar loan products as they currently have other profitable means to provide customers short-term credit.

Some Community and Regional Depository Institutions Said Their Small-Dollar Loan Products Were Not Profitable, but That They Offered Them to Build Relationships and Meet Community Needs

Some representatives from the depository institutions with whom we spoke reported that their small-dollar loan products were not profitable. These institutions reported that underwriting and other expenses equaled or exceeded any fees or interest income they collected. For example, a representative from one institution said its interest income on a $500 loan was $7.40. The representative stated that the cost of underwriting the loan exceeded this amount and that the institution viewed its small-dollar loan as a service to customers rather than a profit-making product.

However, most of the institution officials with whom we spoke reported that profitability was not the focus of their small-dollar loan program; rather, the ability to establish long-term relationships and cross-sell other products was important to them. Relationship-based lending is a form of lending by which a depository institution seeks to establish a long-term relationship with borrowers—based upon the premise that as the relationship develops, the institution will have an opportunity to sell borrowers other products such as loans and checking and savings

[50]*Study of Bank Overdraft Programs.*

accounts. For example, representatives from a credit union membership association that provides technical, underwriting, and marketing support to more than 500 credit unions across one state reported that they marketed their small-dollar loan program as a gateway device to promote long-term credit union membership, which also convinced many credit unions to join. Representatives from the association reported that the program has grown in volume and continues to gain participants—82 credit unions with more than 200 branches have joined the program since it started in October 2006.

Recent Actions May Encourage Wider Availability of Short-Term, Small-Dollar Loan Products

FDIC Conducted a Small Dollar Loan Pilot Program That Resulted in a Template for Small-Dollar Lending by Other Depository Institutions

As discussed earlier, FDIC conducted a 2-year Small-Dollar Loan Pilot Program as a case study to demonstrate how banks can profitably offer affordable small-dollar loans as an alternative to high-cost products such as payday loans and fee-based overdraft programs. The pilot began with 31 bank participants and concluded in the fourth quarter of 2009 with 28 banks ranging in size from approximately $28 million to $10 billion in assets.[51] Participating banks made more than 34,400 small-dollar loans with a principal balance of $40.2 million. The average loan amount for small-dollar loans (loan amounts up to $1,000) was approximately $700 with an average repayment term of 10–12 months. The average loan amount for nearly small-dollar loans ($1,000–2,500) was approximately $1,700 with an average repayment term of 14–16 months. All participating banks made loans within FDIC's targeted 36 percent APR (inclusive of origination fees charged by approximately half of participating banks). According to FDIC, virtually all pilot participants could process loans within 24 hours and many within an hour if borrowers had the requisite documentation.

FDIC identified best practices and lessons learned as a result of its pilot to develop a template for design and delivery elements for safe, affordable, and feasible small-dollar loans that may be replicated by other banks (see

[51]FDIC noted that several banks entered and exited as the pilot progressed.

table 2 below). A majority of the pilot participants reported that they primarily used small-dollar loans to build or retain profitable, long-term relationships with consumers and also to create goodwill in the community. Although the pilot did not specifically track profitability, pilot participants generally indicated that origination and servicing fees for small-dollar loans were similar to those for other loans; and given the size of small-dollar loans, interest and other fees generated were not always sufficient to achieve short-term profitability. According to FDIC, pilot participants reported that a longer loan term was critical to loan performance as it provided consumers a longer time to recover from a financial emergency than a single pay cycle or the immediate repayment often required for fee-based overdraft programs.

Table 2: FDIC's Safe, Affordable, and Feasible Template for Small-Dollar Loans

Product element	Parameters
Amount	$2,500 or less
Term	90 days or more
APR	36 percent or less
Fees	Low or none; origination and other upfront fees plus interest charged equate to APR of 36 percent or less
Underwriting	Streamlined with proof of identity, address, and income, and a credit report to determine loan amount and repayment ability; loan decision within 24 hours
Optional features	Mandatory savings and financial education

Source: FDIC.

Furthermore, FDIC officials noted that pilot participants and others said that a more flexible regulatory environment could encourage them to offer small-dollar loans. More specifically, FDIC reported that several pilot participants believed that small-dollar lending should receive more emphasis in Community Reinvestment Act of 1977 (CRA) examinations even if the programs were relatively small.[52] However, FDIC noted that both its small-dollar loan guidelines and application process for the pilot program indicated that small-dollar loan programs already can receive favorable consideration for CRA purposes, although pilot participants

[52]CRA was enacted to prevent redlining, which is the practice of denying or increasing the cost of banking services to areas that have large minority populations, and instead encourage banks and thrifts to help meet the credit needs of all segments of their communities, including low- and moderate-income neighborhoods. 12 U.S.C. §§ 2901–2908.

reported that examiners were not always aware of this or were not consistent in applying the consideration. Federal regulators examine depository institutions for CRA compliance and assign ratings to individual institutions, which then are made publicly available. Regulators consider the CRA record of depository institutions in evaluating applications for charters or for approval of mergers, acquisitions, and branch openings. A number of pilot participants also said that favorable CRA consideration might provide an incentive for additional institutions to participate in small-dollar lending. They suggested that institutions should receive CRA consideration for offering a small-dollar loan product. For example, a representative from a nonprofit organization specializing in low-income consumer issues, with an emphasis on consumer credit, stated that offering banks CRA consideration would provide an incentive for depository institutions to offer small-dollar loans. But the representative also noted that as long as banks and credit unions could continue to collect overdraft fees from customers, they would have little incentive to offer small-dollar loans.

Although the FDIC pilot has ended, several of the pilot participants with whom we spoke reported that they continue to offer their small-dollar loan products. A representative from FDIC reported that agency officials are planning to travel to a number of different cities to meet with community banks to discuss the pilot and attempt to get more banks involved in making small-dollar loans. More broadly, FDIC continues to work with depository institutions, consumer groups, nonprofit organizations, other government agencies, and others to research and pursue strategies that could prove useful in increasing the supply of small-dollar loan options available to consumers.

Recent Amendments to Regulation E May Affect Overdraft Practices

Recent amendments to Federal Reserve Regulation E, which implements the Electronic Fund Transfer Act, may encourage some depository institutions to offer small-dollar alternatives.[53] These recent changes require depository institutions to provide notice and a reasonable opportunity for customers to opt in to the payment of overdraft fees for ATM and one-time debit card transactions. That is, customers must consent to the payment of overdraft fees for ATM and one-time debit card transactions, which could affect overdraft practices and increase

[53]The Electronic Fund Transfer Act established the rights, liabilities, and responsibilities of parties in electronic funds transfers and protects consumers when they use such systems. 15 U.S.C. § 1693 et seq.; Regulation E, 12 C.F.R. part 205.

consumer awareness of the costs for this short-term credit.[54] FDIC and consumer advocates noted that prior to the recent amendments, participation in some overdraft loan programs was based on automatic enrollment and customers may not have fully understood the risks and potential costs involved. Additionally, consumer advocates assert that overdraft programs are a high-cost form of lending that traps low- and moderate-income consumers into paying high fees. Further, consumer advocates argue that by honoring overdrafts, depository institutions encourage consumer reliance on these programs and therefore, consumers incur greater costs in the long run than they would if the transactions were denied at the outset. If customers opt out of overdraft protection, and depository institutions collect less income from these fees, the institutions may have more incentives to offer small-dollar alternatives to them.

Recent Financial Reform Legislation Established a Loan Loss Reserve Fund to Offset Credit Risk to Depository Institutions That Offer Small-Dollar Loans

The Dodd-Frank Wall Street Reform and Consumer Protection Act includes a provision to establish a grant program within the Community Development Financial Institutions Fund (CDFI).[55] The new program would help designated CDFI's to defray the costs of operating small-dollar loan programs, by providing financial assistance to these institutions to establish their own loan loss reserve fund to mitigate some of the losses from such programs.

Several depository institution officials with whom we spoke reported that access to a loan loss reserve fund to offset credit risk could help to increase depository participation in small-dollar lending. For example, a state credit union association partnered with the state's treasury department to develop a loan loss reimbursement fund because some of the credit unions were hesitant to participate in the association's small-dollar loan program without this assurance. The representatives reported that the loan loss reimbursement fund was an important factor in increasing participation in the small-dollar loan program.

[54] 12 C.F.R. § 205.17(b).

[55] Pub. L. No. 111-203, title XII, § 1206, 124 Stat 1376, 2131 (2010), to be codified at 12 U.S.C. § 4719. A CDFI offers financial products and services in economically distressed target markets, such as mortgage financing for low-income and first-time homebuyers and not-for-profit developers; flexible underwriting and risk capital for community facilities; and technical assistance and commercial loans and investments to small start-up or expanding businesses in low-income areas. The CDFI Fund confers CDFI certification, which is required to access financial and technical award assistance from the Fund through the CDFI Program. 12 U.S.C. §§ 4701-4718.

New Credit Union Regulation Raised the Interest Rate Cap for Small-Dollar Loans

Effective October 25, 2010, the National Credit Union Administration (NCUA) adopted a rule to offer short-term, small-dollar loans at a maximum APR of 1000 basis points above the general interest rate permissible for federal credit unions.[56] Currently, the Federal Credit Union Act imposes a ceiling on the interest rate a federal credit union may charge for credit at 15 percent, but allows the NCUA Board to set a higher interest rate if certain criteria are met. Currently, the Board set rate is 18 percent. According to an NCUA official, this new rate would provide greater flexibility to federal credit unions to offer their members alternatives to payday loans. Generally, credit union representatives with whom we spoke stated that they believed these changes could increase participation in small-dollar lending. However, a representative from one of the federal credit unions was concerned that the rule limited the number of short-term, small dollar loans a borrower could obtain during a specified time period (credit unions cannot make more than three short-term, small-dollar loans in any rolling 6-month period to any one borrower). The representative reported that this would change how the credit union currently operated its small-dollar loan program and could cause some borrowers who use the product to return to payday lenders.

Concluding Observations

Recent statutory and regulatory changes and FDIC initiatives may encourage more institutions to offer small-dollar loan alternatives to payday loans or expand their availability, but many consumers may still choose to use payday loans for their wide availability and relative lack of eligibility restrictions. Concerns about such high-interest lending have not abated as more Americans encounter financial difficulties due to the recent economic downturn. In conducting our work we found limited data available on the payday loan industry that made it difficult to assess the size of the industry, the prevalence of various product offerings, and the ultimate effect of industry practices on federal law enforcement employees or other consumers. While a small number of payday loan companies are publicly traded and information is available on where they operate, the size of their operations, and the types of products they offer, in our discussions with industry representatives, they estimate that thousands of private companies—about which very little is known—offer pay advance products. Some of these companies may operate in states where payday lending is legally restricted, but according to state officials and FTC staff, tracking and monitoring lenders—particularly those that

[56] 75 Fed. Reg. 58285 (Sept. 24, 2010).

operate online—can prove very difficult, as a number of them are small "mom and pop" shops or may be located overseas. However, the creation of the new Consumer Financial Protection Bureau provides an opportunity for the federal government to centrally collect more data on the industry and, within the scope of its authorities, lay a foundation for broader awareness of these alternative financial services providers. Furthermore, although the federal agencies we studied believe they have sufficient information to assess an employee's financial situation and identify those employees in financial distress—and our data analysis suggests relatively low rates of payday loan use by select federal law enforcement employees—any isolated problems could be significant for the individuals involved because the data also suggest some individuals repeatedly use payday loans.

Agency Comments and Our Evaluation

We provided a draft of this report to DHS components (CBP, ICE, TSA, and the Office of the Chief Human Capital Officer), FBI, FDIC, the Federal Reserve, FTC, HHS, OPM, NCUA, and Treasury for their review and comment. CBP and the DHS Office of the Chief Human Capital Officer, FBI, the Federal Reserve, FDIC, and FTC provided us with technical comments that we incorporated as appropriate. Additionally, FDIC commented that they agreed with the findings of the report. HHS, OPM, and Treasury did not provide comments on our draft report.

NCUA provided us with written comments, which are reprinted in appendix IV. NCUA believed the report was well written and thoroughly researched and offered some technical comments that we have incorporated as appropriate.

We are sending copies of this report to interested congressional committees and the Secretaries of the Departments of Health and Human Services, Homeland Security, and the Treasury; the Directors of FBI and OPM; and the Chairmen of the FDIC, Federal Reserve, FTC, and NCUA. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at cackleya@gao.gov or (202) 512-8678. Contact points for our Office of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix V.

Alicia Puente Cackley
Director, Financial Markets
and Community Investment

Appendix I: Objectives, Scope, and Methodology

In this report, we examine (1) how select federal law enforcement agencies become aware of employees who are potential security risks due to financial problems, including payday lending, and (2) various alternatives to payday lending that provide consumers with access to small-dollar loans and more favorable interest rates.

To determine how select federal law enforcement agencies become aware of employees who are potential security risks due to financial problems we focused on four major federal law enforcement agencies—Customs and Border Protection (CBP), Immigration and Customs Enforcement (ICE), Transportation Security Administration (TSA), and the Federal Bureau of Investigation (FBI). To determine what financial information agencies collect on applicants and employees, we met with officials at the Office of Personnel Management (OPM) and the four selected agencies. We obtained information and documentation on the policies and processes these agencies follow when conducting suitability or security clearance investigations of applicants or employees. We specifically considered financial information that is collected and analyzed and spoke with investigators and adjudicators about how this information is used when determining whether someone is suitable for employment or whether to grant a security clearance. When available, we collected data on the number of suitability or security clearances that were denied for financial reasons. When applicable, we also reviewed agency codes of conduct and other personnel standards that apply to the financial status of federal employees.[1] To determine whether employees at the four law enforcement agencies we reviewed sought help for financial matters, we spoke with officials who have knowledge of the agencies' employee assistance programs. When available, we also obtained data on the number of employees from these agencies who seek help on financially related matters. FBI and CBP provided summary data on employees who sought help on financial-related matters. We believe that the data obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

To determine the types of data payday lenders collect and report about their customers, and thus what information would be publicly available to employers when they run a credit check, we spoke with members of the payday loan industry, representatives from two of the three major credit

[1]These agencies have codes of conduct or personnel standards for employees requiring them to stay current on any debt.

bureaus (Experian, Equifax, and TransUnion), and with a company that provides credit-related data that extends beyond information offered by the major credit bureaus. Since some payday lenders pull data from and report to other companies that aggregate data on the “near-prime” market, we collected information on these companies and interviewed one company to see if it collected information from payday lenders that we could use to determine prevalence of payday loan use at the agencies we reviewed. The data they collected on employment was not reliable for our purposes. We also conducted interviews with and collected information from trade organizations that work with payday lenders such as the Consumer Financial Services Association, the Financial Service Centers of America, and the Online Lenders Alliance.

To determine if law enforcement employees at the four federal agencies we examined have salaries that typically fall within the range of the average payday loan borrower, we compared midpoints of salary ranges of law enforcement employees at these agencies with the median salary of a payday loan borrower. We collected data from the human resources departments at CBP, ICE, TSA, and FBI on the number of full-time equivalent (FTE) employees in different law enforcement job series and pay grades.[2] We then calculated the midpoint pay for each pay grade that corresponded to employees in one of the Law Enforcement Officer General Schedule (LEO-GS) pay series—from GS-5 through GS-15—using the 2010 LEO General Schedule for the Washington, D.C. locality. We averaged the pay at step 5 and step 6 of these salary ranges.[3] We charted this information to show the number of FTE employees at each agency for each average LEO-GS salary level. We compared these salary ranges with the median household income of a payday loan borrower as identified by the Center for American Progress using data from the Board of Governors of the Federal Reserve System’s (Federal Reserve) Survey of Consumer Finances for 2007.[4] The study estimates the median household income to be $30,892, which we adjusted for inflation to be $32,712 in 2010.[5]

[2]FBI provided data on all FTE employees (law enforcement and nonlaw enforcement) because all FBI employees are required to hold a security clearance.

[3]For example, for employees in the LEO-GS-9 pay grade for Washington D.C. locality, we calculated the midpoint salary as $61,092, which is the average of LEO-GS-9, step 5 ($60,232) and LEO-GS-9, step 6 ($61,952).

[4]Center for American Progress, *Who Borrows from Payday Lenders: An Analysis of Newly Available Data* (March 2009).

[5]According to the Federal Reserve, the data from the 2007 Survey of Consumer Finances is the most recent, and the first to collect data specific to payday loans.

According to the Federal Reserve, 2.4 percent of families surveyed reported using a payday loan, and payday loan use was essentially limited to the bottom three income quintiles with medians of $12,300; $28,800; and $47,300. The median household income estimate derived from the 2007 Federal Reserve survey data is consistent with estimates from other studies we reviewed, including those focused at the federal, state, and local levels. For example, a study conducted by the California Department of Corporations in 2007 found that 48.3 percent of payday loan borrowers in the state reported their income as below $40,000. Another study conducted in 2001 by the Credit Research Center at Georgetown University indicated that more than half of payday loan borrowers from a nationally representative sample of payday loan customers had incomes between $25,000 and $49,999. Since the Federal Reserve survey covered a more recent national sample, we concluded that it was the most relevant for our purposes. The other studies were consistent with the Federal Reserve's survey findings. Our analysis in appendix II shows that all of the federal law enforcement employees at the four agencies we reviewed have salaries that are higher than that of the median household income of a payday loan borrower. We believe that the data obtained provide a reasonable basis for our findings and conclusions based on our audit objectives. For the results of our salary range analysis, see appendix II.

In addition to average customer income information, we attempted to understand the composition of the payday lending industry by obtaining information from payday lenders and reviewing information from industry experts on the state of the payday loan industry, including market share, growth projections, current legislative issues, and regulatory issues. We also conducted an analysis from five lending companies of borrowing by employees at the four agencies we reviewed. We contacted several representatives of the payday loan industry and received cooperation from five companies, including from two of the largest payday lending companies, to gain an understanding of (1) what data the industry collects from its borrowers and (2) how many federal employees at the four agencies we reviewed use payday loans. We requested that the companies search their databases on the field "employer" to identify borrowers obtaining loans from January 1, 2010, to July 31, 2010, who indicated as their employer one of the four agencies we reviewed.[6] We asked the companies to search on the full name of the agency as well as the acronym and any common misspellings. Based on these searches, each of the five

[6]One lender provided us data from January 1–July 26, 2010.

companies that responded to our request provided us with data on the number of borrowers who listed their employer as one of the four law enforcement agencies in the scope of our work. The companies also provided us data on the total number of transactions, in the aggregate, conducted by the same group of borrowers. Based on the data reported, it is not apparent if a borrower used one or multiple payday loans during the time period we requested. Furthermore, it is possible that a customer from one lending company that provided us data also could have been a customer at another lender that provided us data from this same time period. Therefore, the number of customers cannot be added to provide a total number of borrowers from the agencies we reviewed. Since we did not audit the information systems from which the data were pulled, we cannot assure the accuracy of the data, but believe this information provides a limited snapshot of the population borrowing from these lenders. However, we did discuss with these companies the data reliability measures and controls they have in place for the systems from which they pulled data. We believe these data provide a point-in-time estimate of payday loans these five companies provided to employees at the four agencies we reviewed and are reliable for our purposes. We also believe that the data obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. This information cannot be used to project the prevalence of payday lending among federal employees or employees at the agencies within our scope. See appendix III for our lending analysis.

To identify the alternatives to payday lending that are available for consumers needing small-dollar loans, we spoke with a number of banks and credit unions, including some federal and state employee credit unions, offering small-dollar loan products. Many of these banks were participants in the Federal Deposit Insurance Corporation's Small-Dollar Loan Pilot Program, which concluded in June 2010. During semi-structured interviews we asked representatives of these institutions to describe how their programs operate, who is eligible, the fees they charge, and how many loans they have made. We also asked these representatives to identify what could be done to encourage more financial institutions to offer small-dollar loans. Through a literature search, interviews, and online searches, we identified other models for small-dollar loans such as relationship lending, overdraft lines of credit, partnership programs, and salary advances. We also interviewed consumer groups and trade organizations that conduct research on unbanked and underbanked populations to identify alternative models to payday lending that are being employed or developed. We identified other models for small-dollar loans offered by alternative financial services providers such as prepaid cards, car title, pawn, and installment loans.

To understand regulatory oversight of the payday loan industry, we conducted interviews with officials at the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, Federal Trade Commission, and the National Credit Union Administration. We collected information from these agencies about their regulation of financial institutions that make payday loans and depository institutions that provide small-dollar loans. We also held a discussion with the Attorney General of West Virginia to understand how oversight and criminal misconduct of online payday lenders is handled at the state level. We selected West Virginia as an example of a state that since 2006 has taken legal action to enforce state prohibition of payday lending.

We conducted this performance audit from June 2009 through January 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Federal Law Enforcement Salaries Compared with Median Household Income of Average Payday Loan Borrower

The figure below shows the distribution of the salary ranges and number of law enforcement personnel at the Department of Homeland Security (DHS) in Customs and Border Protection (CBP), Immigration and Customs Enforcement (ICE), Transportation Security Administration (TSA), and at the Federal Bureau of Investigation (FBI). This analysis shows that federal law enforcement employees at FBI and the three DHS components we reviewed have salaries that typically are higher than that of the median household income of a payday loan borrower ($32,712).[1] The distribution of salaries for law enforcement employees at these agencies ranged from the Law Enforcement Officer General Schedule (LEO-GS) 5 level to the LEO-GS-15 level.[2] The number of employees peaked at different salary ranges for each of the components but all of the peaks were above the household income of $32,712. For example, 48.2 percent of law enforcement employees at CBP have salaries at the LEO-GS-11 level, which corresponds to a salary of $62,467–81,204. More than half of law enforcement employees at ICE fell into two salary ranges—25.7 percent had salaries at the LEO-GS-9 level ($53,350–68,834) and 30.1 percent had salaries at the LEO-GS-13 level ($89,033–115,742). At TSA, law enforcement salaries tended to be a little lower with the majority of employees (53 percent) having a salary at the LEO-GS-9 level ($53,350–68,834). Lastly, FBI employees in law enforcement positions tended to cluster around the LEO-GS-13 salary level (41.7 percent) which corresponds to a salary range of $89,033–115,742.[3] Furthermore, federal law enforcement employees receive additional Law Enforcement Availability Pay, which is a type of premium pay for law enforcement officers who are criminal investigators. This additional pay, along with

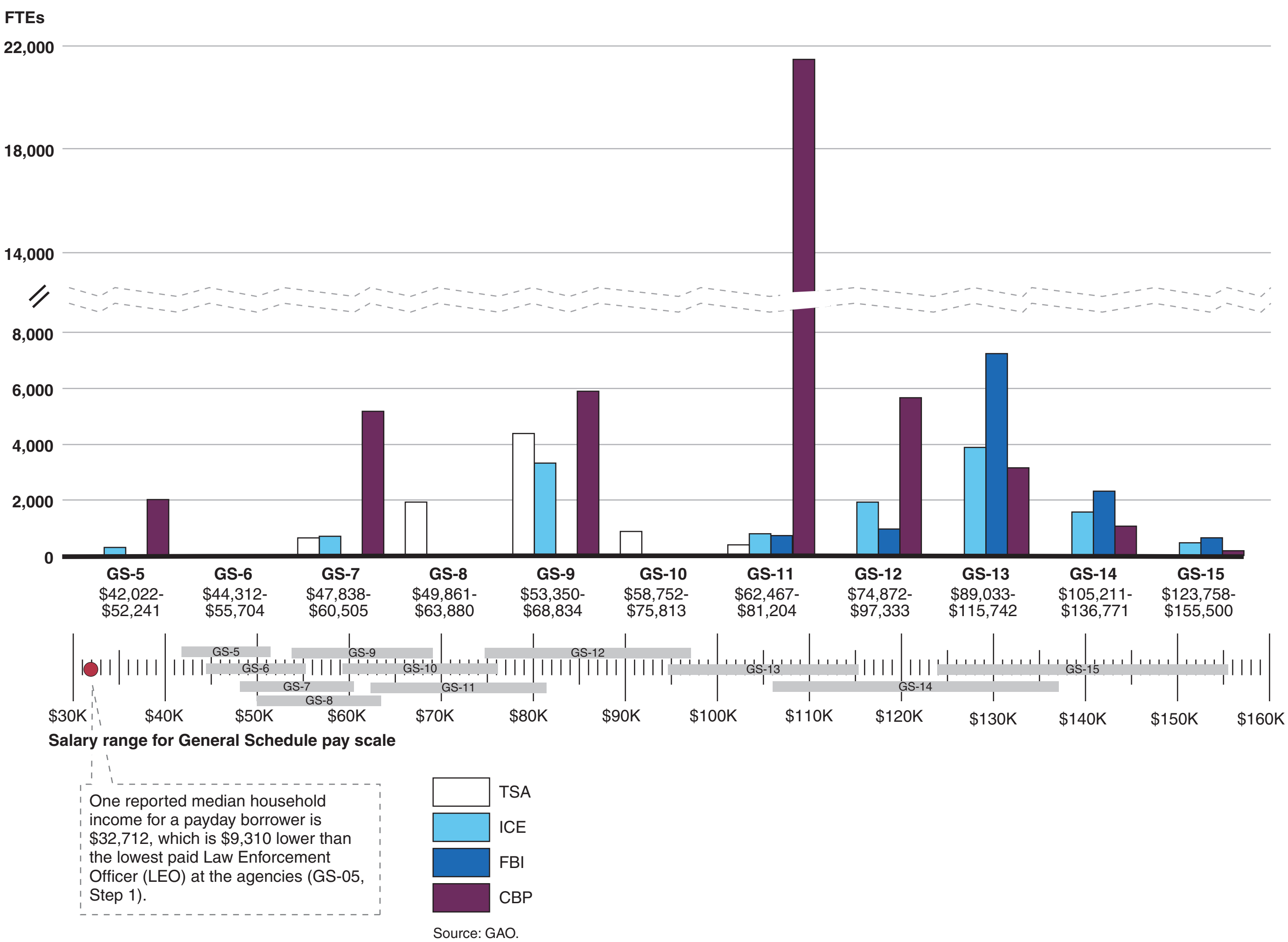
[1]This estimate comes from the Center for American Progress using data from the Board of Governors of the Federal Reserve's Survey of Consumer Finances for 2007. The study estimates the median household income to be $30,892 and the mean to be $32,614. For figure 3, we used the median household income estimate as a better middle estimate of income distribution which we adjusted for inflation to be $32,712 in 2010. This estimate is consistent with estimates from other studies we reviewed, including those focused at the federal, state, and local levels.

[2]For comparative purposes, the following full-time equivalent positions were not included in the table: an additional 1,906 law enforcement positions at the FBI that were categorized in non-graded positions; 25 CBP law enforcement positions that were reported at grades LEO-GS-1; an additional 24 TSA law enforcement positions that were reported at grades LEO-GS-1 and LEO-GS-2; and additional 34 ICE law enforcement positions that were reported at the Senior Executive Schedule pay scale which differs from the General Schedule and has salaries above the GS-15 level.

[3]We reported salary ranges from the LEO-GS schedule, the 2010 Federal Law Enforcement General Schedule for Washington, D.C. locality.

other benefits federal employees receive such as health and disability insurance, may provide an additional financial cushion to federal law enforcement employees. We believe that the data obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Figure 4: Federal Law Enforcement Salaries at Four Agencies Compared with the Median Household Income of the Average Payday Loan Borrower Based on Fiscal Year 2009 Personnel Data



Source: GAO.

Note: We analyzed fiscal year 2009 data from DHS, FBI, and the Office of Personnel Management's 2010 General Schedule for law enforcement in the Washington D.C. locality. The median household income estimate is from a Center for American Progress study of the Federal Reserve's 2007 Survey of Consumer Finances adjusted for inflation to 2010 dollars. FTEs included in this figure do not include LEAP or other premium pay.

Appendix III: Summary of Payday Loans by Employees at Four Federal Law Enforcement Agencies

To help identify the scope of payday loan usage among employees at the Department of Homeland Security (DHS) in Customs and Border Protection (CBP), Immigration and Customs Enforcement (ICE), Transportation Security Administration (TSA), and at the Federal Bureau of Investigation (FBI), we compared the number of full-time equivalents (FTE) at each agency with customer data received from the payday loan industry. Data on payday loans made during a 7-month period in 2010 from five payday lending companies indicate that customers reporting employment with one of the four identified federal agencies represent about 0.7 percent of the total FTE population at these four agencies in 2009 (see table 4).[1] The lowest usage of 0.15 and 0.18 percent of the agencies' total FTE population was reported for ICE and FBI. The highest usage of 1.57 percent was reported for TSA. While this does not indicate a widespread problem, usage among employees at TSA was almost ten times the usage among employees at ICE and more than five times the usage among employees at CBP. The five payday loan companies that provided us data on their customers represent approximately one-fifth of the 2009 industry total of cash advances originated and operated approximately one quarter of all payday lending storefronts in 2009.[2] Each of the five payday lending companies submitting customer data reported that employees of CBP, ICE, TSA, or FBI accounted for less than 1 percent of each company's total customer base. For example, company 1 reported a total customer base of 996,157 for the 7-month reporting period; of this total, no more than 0.06 percent of customers reported employment with CBP, ICE, TSA, or FBI. While each company reported a small number of federal law enforcement employees as having taken a payday loan, these data are limited and cannot be used to project the prevalence of payday lending among federal employees or among these specific federal employee populations. We believe that the data obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[1]The FTE data includes employees classified in both law enforcement and nonlaw enforcement positions.

[2]According to an industry official, more than 2,300 distinct payday lending companies currently are in operation; while some companies operate a single storefront, others manage multiple locations.

Table 3: Number of Payday Loan Customers at Five Payday Loan Companies from January 1, 2010, to July 31, 2010, Who Identified Their Employer as One of Four Federal Law Enforcement Agencies

		Distinct Customers						
Government Agency	FTEs fiscal year 2009 (enacted)[a]	Company 1[b]	Company 2	Company 3	Company 4	Company 5	Total distinct customers from five companies	Total distinct customers as percentage of FTE counts
CBP	55,457	115	23	6	3	11	**158**	**0.28%**
TSA	51,618	463	144	98	37	68	**810**	**1.57%**
ICE	20,130	15	8	1	1	6	**31**	**0.15%**
FBI	33,695	32	15	4	0	9	**60**	**0.18%**
Total all agencies	**160,900**	**625**	**190**	**109**	**41**	**94**	**1,059**	**0.66%**
Percent of total customer base	**n/a**	**0.0600%**	**0.0471%**	**0.0421%**	**0.0005%**	**0.0180%**	**n/a**	**n/a**

Source: GAO analysis of industry data.

[a]Enacted refers to the actual number of FTEs funded in fiscal year 2009.

[b]Data from this company covers the period January 1–July 26, 2010.

Table 5 shows the number of distinct payday loan transactions made by employees of CBP, ICE, TSA, or FBI with one of five identified lending companies during the same 7-month period. While company totals reflect an average of 2.56–6.06 transactions per customer within the specified population, company data do not distinguish between multiple- and single-use borrowers. For example, company 1 reported an average of 5.94 transactions for the 115 CBP-employed borrowers but did not break these data down to actual transactions per individual borrower. Hence, one borrower may have engaged in 10 or more transactions, while another accepted only one loan during the same period. Additionally, company data do not distinguish between original loans and rollover loans or loans that are extended beyond the maturation date for an additional fee (as might be the case when a borrower is unable to repay the loan at the time it is due). For instance, data provided by company 2 indicate that each customer reporting employment with TSA engaged in an average of six transactions during this 7-month period. While one customer may have accepted 6 or more loans, another customer may have rolled over the same loan multiple times; in the latter instance, the loan is recorded as a distinct transaction each time it is rolled over. Without more detailed information, it is difficult to know the level of concern—if any—payday loan use should elicit among security officials at these agencies. An individual who borrowed only once may not be in serious financial distress while an individual who rolled over a loan several times or took out more than one loan may be in significant financial distress and of more concern to agency officials.

Table 4: Number of Payday Loan Transactions Conducted from January 1, 2010, to July 31, 2010, at Five Payday Loan Companies by Individuals Who Identified Their Employer as One of Four Federal Agencies

Government Agency	FTEs fiscal year 2009 (enacted)	Distinct customers	Total number of transactions	Average number of transactions per customer
Company 1				
CBP	55,457	115	683	5.94
TSA	51,618	463	2,742	5.92
ICE	20,130	15	79	5.27
FBI	33,695	32	72	2.25
Total[a]	**160,900**	**625**	**3,576**	**5.72**
Company 2				
CBP	55,457	23	132	5.74
TSA	51,618	144	804	5.58
ICE	20,130	8	29	3.63
FBI	33,695	15	99	6.6
Total	**160,900**	**190**	**1,064**	**5.6**
Company 3				
CBP	55,457	6	30	5
TSA	51,618	98	603	6.15
ICE	20,130	1	6	6
FBI	33,695	4	21	5.25
Total	**160,900**	**109**	**660**	**6.06**
Company 4				
CBP	55,457	3	8	2.67
TSA	51,618	37	141	3.81
ICE	20,130	1	1	1
FBI	33,695	0	0	0
Total	**160,900**	**41**	**150**	**3.66**

Government Agency	FTEs fiscal year 2009 (enacted)	Distinct customers	Total number of transactions	Average number of transactions per customer
Company 5				
CBP	55,457	11	31	2.82
TSA	51,618	68	177	2.60
ICE	20,130	6	23	3.83
FBI	33,695	9	13	1.44
Total	**160,900**	**94**	**244**	**2.56**

Source: GAO analysis of industry data.

[a]Data from company 1 covers the period January 1, 2010–July 26, 2010.

Appendix IV: Comments from the National Credit Union Administration

National Credit Union Administration

Office of the Chairman

January 18, 2011

Ms. Alicia Puente Cackley
Director
Financial Markets and Community Investment
Government Accountability Office
441 G Street, NW
Washington, DC 20548

Re: Payday Lending: Federal Law Enforcement Uses a Multilayered Approach to Identify Employees in Financial Distress, GAO-11-147

Dear Ms. Cackley:

NCUA appreciates the opportunity to comment on GAO's payday lending study examining the use of payday loans by federal employees in law enforcement and national security positions. As the independent federal agency that charters and supervises federal credit unions, NCUA has spent considerable time and effort developing the means for federal credit unions to become a viable alternative to traditional payday lenders. As noted in the report, NCUA recently promulgated a rule that allows federal credit unions to offer short-term, small dollar loans under certain limits and with appropriate consumer protections. NCUA's hope is that this rule will aide federal credit unions in fulfilling their mission of providing affordable credit to members, particularly those members of modest means.

NCUA understands the dangers that predatory payday loans pose to individual borrowers and the nation as a whole and supports the efforts of GAO to investigate any possible threat payday loans may pose to our national security. While we believe the report is well written and thoroughly researched, we do have the following comments that we believe will make the report more accurate:

1. On page 4, in the first full paragraph, the report states that GAO spoke with representatives of a number of banks and credit unions that offer small-dollar loans and that many of these institutions participated in the FDIC's Small-Dollar Loan Pilot Program. As written, these statements seem to imply that some credit unions participated in the FDIC's Pilot Program, which is not accurate. We suggest modifying this paragraph so that it is clear that only banks participated in the pilot program. We note that a similar statement appears on page 45.

2. On page 4, in the first paragraph under the Background section, we suggest adding credit unions to the end of the first sentence. With the suggested change, this sentence would read: "Payday lenders are one of many providers of alternative financial services – products or services that operate outside of federally insured banks, credit unions, and thrifts." This addition would ensure credit unions are considered along with banks and thrifts.

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Ms. Alicia Puente Cackley
January 18, 2011
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3. On page 6, the Art Explosion shows that a payday loan customer has an "appointment for repayment." In our research we typically see this date being referred to as the repayment date. We are concerned that the use of the phrase "appointment for repayment" may be misleading as to the actual protocol with payday lending.

4. On page 8, in the second full paragraph, the report states that the APR that payday lenders can charge to members of the military is 36%, but does not reference fees. We suggest modifying this sentence to include a reference that the APR includes all fees and charges connected with the making of the loan and is different than the APR calculation in Regulation Z.

5. On page 39, we suggest revising the section on NCUA's Short-term, Small dollar loan program, up to the sentence that begins with "According to an NCUA official," to read as follows:

   New Credit Union Regulation Raised Interest Rate Cap for Small-Dollar Loans

   Effective October 25, 2010, the National Credit Union Administration (NCUA) adopted a rule to allow federal credit unions to offer short-term, small-dollar loans at an APR that is 1000 basis points above the interest rate ceiling as set by the NCUA Board. The Federal Credit Union Act imposes an interest rate ceiling of 15%, but allows the NCUA Board to set a higher interest rate if certain criteria are met. Currently, the Board set rate is 18%. This new rule does not prohibit federal credit unions from continuing or participating in any other payday lending program that is legal under NCUA's regulations, but does offer federal credit unions a viable alternative structure. In order to take advantage of the higher rate, federal credit unions must make loans in accordance with the requirements of the rule, which include charging only an application fee that does not exceed $20, limiting the number and amount of loans a borrower may receive, not offering roll-overs, and other provisions designed to protect the borrower and the safety and soundness of the institution.

Again, we thank you for the opportunity to comment on this report and will be happy to assist GAO in the future on this or any other issue.

Sincerely,

Debbie Matz
Chairman

Appendix V: GAO Contacts and Staff Acknowledgments

GAO Contact

Alicia Puente Cackley, (202) 512-8678 or cackleya@gao.gov

Staff Acknowledgments

In addition to the individual named above, Debra Johnson, Assistant Director; Beth Garcia; Daniel Kaneshiro; David Maurer; Marc Molino; Linda Rego; Barbara Roesmann; Rachel Siegel; Andrew Stavisky; and Andrea Yohe made key contributions to this report.

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