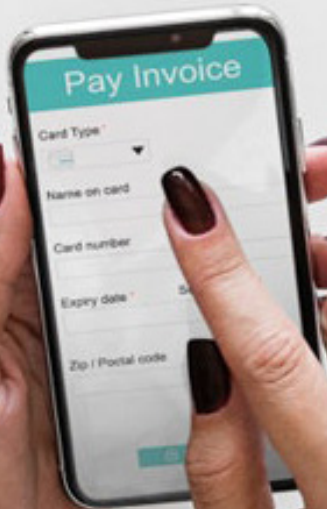


IS NEW REALLY NEW?

FINANCIAL TECHNOLOGY &
ITS IMPACT ON LOW-INCOME
FAMILIES



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Heartland Alliance — the leading anti-poverty organization in the Midwest — believes that all of us deserve the opportunity to improve our lives. Each year, we help ensure this opportunity for nearly one million people around the world who are homeless, living in poverty, or seeking safety. Our policy efforts strengthen communities; our comprehensive services empower those we serve to rebuild and transform their lives.

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Illinois Asset Building Group (IABG) is a statewide coalition committed to supporting the financial security of Illinois families. IABG advocates for policy solutions that close the racial wealth divide, expand savings opportunities, and protect Illinoisans from predatory financial products and practices. IABG is a project of Heartland Alliance.

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IS NEW REALLY NEW?

Financial technologies, or fintech, is technology used to provide banking or financial services, often by non-bank firms.¹ The emergence of fintech brings with it significant consumer protection concerns about predatory practices facilitated through technology changes. Fintech includes a broad range of financial products and services, including online payday loans, apps to help you manage your money, and cryptocurrency. These online and mobile services are often described as “new” or “innovative.” The reality is that fintech does not necessarily provide new financial services, but rather primarily changes the ways banking and financial services are delivered.

Fintech is a growing and heavily promoted section of the financial market, and companies are eager to capitalize on people’s need for financial services. In the course of a day, you may check how you are doing on your budget via Mint, transfer money via PayPal or Venmo to a friend, or use an online lender to get an advance on your paycheck, automatically renewing each pay period and charging you hundreds of dollars in fees.

Consumers take on a lot of risk in these transactions. It is often unclear what happens with your personal data that is collected, what the true cost and fees are, what security is in place to prevent data leaks, and whether the technology will be able to deliver on the promises it makes. Fintech also creates a new platform for predatory products, like payday loans that are offered online.

THE RACIAL WEALTH DIVIDE & THE NEED FOR STRONG CONSUMER PROTECTIONS IN THE FINTECH MARKET

These financial products are not new, but are actually the same products in new packages. For nearly all fintech products, there are already laws and regulations that apply to the underlying financial transaction. Venmo and Paypal provide money transfers, which are already regulated under money transmission laws. Online payday lenders simply offer payday loans that are subject to state laws - not any kind of new product.

Despite the fact that there are existing laws that should apply to fintech products,

¹ Non-bank means the institution or organization does not have oversight under federal bank regulators such as the Department of Treasury, Department of Commerce, FDIC, OCC and Federal Reserve Board of Governors.

consumers are still at great risk when using financial technologies. Because of the new methods of product or service delivery and because it is an emerging market, regulators are often unclear about what regulations apply to these products. Even worse, some fintech companies, particularly online payday lenders, find ways to evade existing consumer protections.

The emerging fintech market is reminiscent of the early days of the mortgage crisis, when loans labeled as “innovative” were, in fact, incredibly predatory and harmful. Unregulated and “innovative” financial products that have high or hidden fees, lack underwriting, or have high interest rates cause the most harm to people experiencing poverty and communities of color, and contribute to the growing racial wealth divide.

Certain forms of fintech, like banking apps, do have the potential to increase access to safe, affordable banking products. However, existing consumer protections and regulatory oversight of fintech products must be strengthened to ensure that consumers, particularly low-income consumers, are not harmed in the name of “innovation.”

This policy brief provides an overview of the main segments of the fintech market – online loans, money management apps, mobile wallet and payment apps, and cryptocurrency; highlights concerns with these products; and offers policy recommendations to strengthen consumer protections and ensure that the fintech market is fair for consumers.

Financial Insecurity & the Racial Wealth Divide

Nearly one third of Illinois families do not have enough savings to survive for three months at the poverty level if they lost their main source of income. What’s more, across all measures of financial wellbeing, there are significant racial disparities. White households in Illinois have 29 times the wealth of black households and nearly five times the net worth of Hispanic households.² This racial wealth divide is the result of historical and current policies – including financial systems regulations – that disproportionately funnel wealth to white households, while excluding and stripping wealth from people of color.

ONLINE LOANS

Loans can be obtained online and through mobile apps for mortgages, student loans, auto loans, payday loans, and other installment loans. Lenders may follow traditional lending models or make loans using non-bank marketplace lending models where individuals are able to borrow money without the use of a traditional financial institution as an intermediary.

Concerns: Many of the concerns with online lending stem from the lack of transparency in the lending process in addition to the terms of the loan itself. When a borrower completes

² Prosperity Now (2018). Scorecard. Found at: <http://scorecard.prosperitynow.org/>.

an online search or clicks on a link, they are often taken to a lead generator instead of an actual lender. This lead generator then collects the borrower's sensitive personal and financial information and sells it to multiple lenders, often without the borrower being aware of who their information is being sold to. As a result, borrowers have a difficult time determining whether calls offering loans or demanding repayment are from authorized lenders or other parties that have obtained their information. Even when someone does not go through a lead generator, the terms and cost of the loan are often not clear in the online loan application process.

Online borrowers may also be more at risk of fraudulent deposits and withdrawals from their accounts. A report from the Pew Charitable Trusts found that one in three borrowers experienced an unauthorized withdrawal³ because their bank account information had been sold as part of the information collected from lead generators. Additionally, through a variety of mechanisms, many online lenders attempt to evade state interest rate caps in order to keep borrowers unprotected from triple-digit interest rates.

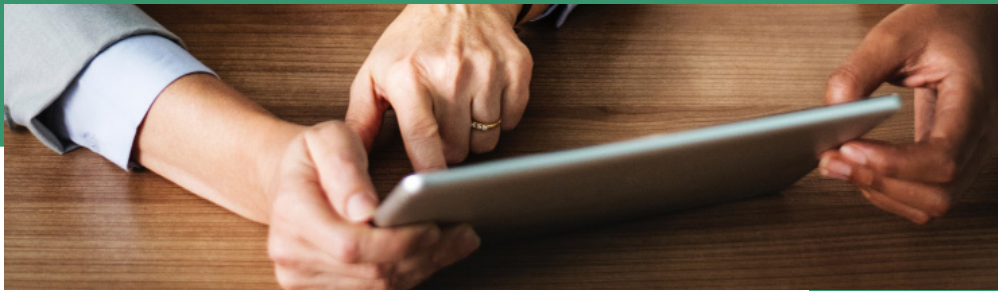
Consumer Loan Example: Elevate

While Elevate claims to be founded “on a legacy of data and innovation coupled with a customer-first approach,”⁴ the company is actually just an online lender that offers high-interest installment loans to individuals already experiencing financial hardship. Elevate actively markets its products to individuals who have subprime credit scores. The company argues that its highest interest rate of 299% is lower than those found in traditional payday loans, and it spreads payments out over a longer period making it easier for lower income individuals to repay successfully. However, the reality is that these loans have extremely high interest rates that trap borrowers in debt that they cannot afford to repay. The result is an extremely high number of loans ending being defaulting or getting charged-off. For example, in 2014, the CFPB calculated nationwide charge-off rates for Enova, the parent company of Elevate, at 50% their outstanding loans. These defaults are just the tip of the iceberg for consumers, leading to aggressive debt collection tactics, overdraft fees, and other harms.

There are many complaints filed with the Better Business Bureau⁵ and the Consumer Financial Protection Bureau⁶ that describe difficulties getting in touch with Elevate representatives, people being approved for loans they did not apply for, and misleading

³ The Pew Charitable Trusts (2014). *Fraud and Abuse Online: Harmful Practices in Internet Payday Lending*. Retrieved December 17, 2018 from: https://www.pewtrusts.org/~media/assets/2014/10/payday-lending-report/fraud_and_abuse_online_harmful_practices_in_internet_payday_lending.pdf

⁴ National Consumer Law Center (2016). *Misaligned Incentives: Why High-Rate Installment Lenders Want Borrowers who will Default*. Found at: https://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-misaligned-incentives.pdf.



expectations for loan repayment terms. Elevate is serving sub-prime borrowers, but instead of increasing access to safe, affordable loan products they are increasing access to predatory loans that take money from individuals who are already living paycheck to paycheck.

Student Loan Example: SoFi

SoFi is an online lender that markets itself as the leading student loan refinancing provider.⁷ In SoFi's advertising, they claim that the average lifetime savings of people who refinance their student loans with SoFi is over \$22,000. The Federal Trade Commission filed a complaint against Social Finance, Inc., the parent company of SoFi, alleging that the company made false statements about its student loan refinancing savings in its advertisements. When calculating new borrower savings for their advertisements, SoFi was selective in which borrowers to include in their calculations in order to maximize the reported savings and mislead borrowers. In order to settle these charges, SoFi agreed to stop misrepresenting the amount of borrowers will save from refinancing their loans with them.

Online Mortgage Lending

It has been claimed that online lending will reduce or eliminate discrimination in financial products such as mortgages. However, a recent study found that online mortgage lending continues to perpetuate discriminatory practices.⁸ Instead of outright denying Latinx or African American borrowers, fintech lenders charged them higher interest rates when compared to white borrowers with the same profiles.

Fintech lenders use both traditional and non-traditional data in order to determine someone's likelihood of defaulting on a loan. Due to a history of exclusion from financial wealth, data may indicate that borrowers who are African American or Latinx are more likely to default on a loan. The use of algorithms and non-traditional data in lending has been promoted as increasing access to financial services for individuals

⁵ Data retrieved from the Better Business Bureau on December 17, 2018 for RISE Credit. Current data can be found here: <https://www.bbb.org/worth/profile/credit-services/rise-credit-0825-235982544/complaints>

⁶ Data retrieved from the Consumer Financial Protection Bureau's Consumer Complaint Database on December 17, 2018 for Risecredit, LLC. Current data can be found here: https://www.consumerfinance.gov/data-research/consumer-complaints/search/?company=Risecredit%2C%20LLC&from=0&searchField=all&searchText=&size=25&sort=created_date_desc

⁷ SoFi (2018). Refinance Student Loans. Retrieved December 17, 2018 from: <https://www.sofi.com/refinance-student-loan/>

⁸ Bartlett, R., Morse, A., Stanton, R. & Wallace, N. (2018). Consumer-Lending Discrimination in the Era of FinTech. Retrieved from: <https://faculty.haas.berkeley.edu/morse/research/papers/discrim.pdf>

FINTECH

MOBILE APPS AND OTHER TECHNOLOGY USED TO SUPPORT OR ENABLE BANKING AND FINANCIAL SERVICES.



who have traditionally been excluded, but the reality is that these algorithms and models reflect and perpetuate existing inequalities. Since these algorithms are considered proprietary, meaning the individual variables used in the algorithms are not disclosed, it is challenging for regulators to determine whether discrimination is occurring according to U.S. fair lending laws.

MONEY MANAGEMENT APPS

In addition to loans, fintech applications (apps) provide a spectrum of financial services and are generally accessed via a smartphone or tablet, while some have an online platform as well. These apps allow people to create and manage a budget, round up spending transactions to put money in savings or investment accounts, or keep tabs on bank account balances to protect against overdraft fees.

None of these financial services are new – they are just being delivered through new technology. For instance, an app that allows you to round up your purchases to save is simply providing a money transmission service, which is a longstanding financial service. The difference is that it is provided through apps and over the internet.

Concerns: In order for the majority of these apps to work, the consumer must share personal and financial account information. If the app does not have appropriate security measures in place, that sensitive information is vulnerable to hacking from other parties. Many apps also have unclear disclosures and hidden fees. For example, many apps claim that the services are free, but that may only be for the first month or a restricted set of services. Many apps also subject the consumer to advertising in order to bring in revenue, which can lead to advertisements for predatory products, like payday loans. Since the app is tracking your spending and often your search history, it targets the ads for products and services that are most likely to be clicked, regardless of whether it is in the best interest of the consumer.

Example: Mint is an app that can pull all of a person's financial information into one location. The app will analyze your spending transactions, automatically create a budget, and provide alerts if a bill is due soon to help people stay on top of their finances. Mint makes money through advertising, and many consumers have recently complained about the increase in credit card ads they are seeing. The app also requires frequent re-entry of sensitive bank account data due to technical glitches, and consumers complained that it

⁹ Mint (2018). Terms of Use. Retrieved December 17, 2018 from: <https://www.mint.com/terms>

was difficult to delete their accounts and stop sharing personal financial information. This is especially concerning because one way Mint generates revenue is through the sale of aggregate consumer data,⁹ and the more accounts they have access to, the more data they can sell.

MOBILE PAYMENT & DIGITAL WALLET APPS

Mobile payment apps are a rapidly growing market and are becoming increasingly ubiquitous in people's lives. These apps allow you to transfer money almost instantly to family and friends or make online or in-store purchases without ever needing to touch cash or a credit card.

Concerns: While mobile payment apps have made it easier for people to transfer money, it has also opened up the door for fraud. Scammers are able to exploit the weaknesses of many fintech applications, such as a lack of buyer protections, absent transaction notifications, and weak identity verifications in order to defraud consumers who often lack recourse to recover lost funds.

For apps that also serve as digital wallets, which store your electronic funds until your next transaction, there are additional risks involved as these balances may not be FDIC insured. Digital wallets may freeze, suspend, or cancel your account for seemingly arbitrary reasons that can take months to resolve, leaving you without access to the funds held in those accounts.

Example: Zelle is a service used by large, mainstream banks that allows people to electronically transfer money, often within seconds, from their bank account directly to another person.¹⁰ Many people assume that since the app is backed by their bank, they are not responsible for fraudulent transactions. However, Zelle does not protect a consumer if a seller does not deliver what was promised, as user-authorized transactions are not considered fraudulent.¹¹

¹⁰ Zelle (2018). How It Works. Retrieved December 17, 2018 from: <https://www.zellepay.com/how-it-works>

¹¹ Shifflett, S. & Jounes, C. (2018). Buyer Beware: Hundreds of Bitcoin Wannabes Show Hallmarks of Fraud. Retrieved December 17, 2018 from: <https://www.wsj.com/articles/buyer-beware-hundreds-of-bitcoin-wannabes-show-hallmarks-of-fraud-1526573115>

¹² Consumer Financial Protection Bureau (2014). Risks to Consumers Posed by Virtual Currencies. Retrieved January 25, 2019 from: https://files.consumerfinance.gov/f/201408_cfpb_consumer-advisory_virtual-currencies.pdf

¹³ Internal Revenue Service (2014). Notice 2014-21. Retrieved January 25, 2019 from: <https://www.irs.gov/pub/irs-drop/n-14-21.pdf>; Commodity Futures Trading Commission (2018). CFTC Backgrounder on Oversight of and Approach to Virtual Currency Futures Markets. Retrieved January 25, 2019 from: https://www.cftc.gov/sites/default/files/idc/groups/public/%40customerprotection/documents/file/backgrounder_virtualcurrency01.pdf; U.S. Securities and Exchange Commission (2018). Statement on Digital Asset Securities Issuance and Trading. Retrieved January 25, 2019 from: <https://www.sec.gov/news/public-statement/digital-asset-securities-issuance-and-trading>

¹⁴ See for example: <https://www.cnn.com/2017/11/17/many-icos-are-fraud-according-to-ethereum-co-founder-and-ripple-ceo.html>, <https://www.reuters.com/article/us-crypto-currency-crime/hacked-scammed-and-on-your-own-navigating-cryptocurrency-wild-west-idUSKCN1MS0F7>, and <http://fortune.com/2017/12/08/bitcoin-theft/>.

CRYPTOCURRENCY

Cryptocurrency is a type of electronic money. Cryptocurrency is not backed or guaranteed by a government. Cryptocurrency is named for the cryptographic proof used to prevent “double-spending” – that is, creation of duplicate digital coins. Cryptocurrency transactions are approved in blocks; these blocks are recorded on blockchains.

Ownership and control of cryptocurrency is tied to a cryptographic key, which is a string of characters. Keys can be stored in a wallet, which can range from a printed piece of paper, to a hardware device like a USB, or a mobile app that runs on your phone. Most cryptocurrency owners acquire and store their coins at a cryptocurrency exchange. While some exchanges match coin sellers to one another, most accept dollars in exchange for cryptocurrency.

Concerns: Cryptocurrency and its related technology and uses are evolving so quickly that it is often difficult to understand for consumers and regulators alike. For example, the Internal Revenue Service, Commodity Futures Trading Commission, and U.S. Securities and Exchange Commission all take different approaches to cryptocurrencies.

Scams are rampant. The Wall Street Journal investigated over 1,000 initial coin offerings, where companies raise funds by selling their own digital currency, and found that nearly 20% of them appeared to be fraudulent.

Hacking and user error can result in consumer losses. Consumers can easily lose their keys, thus losing access to their cryptocurrency. Security is a significant concern, as hackers frequently target cryptocurrency exchanges and wallets. Consumers may have trouble accessing their coins or help with their cryptocurrency wallets, even at established exchanges.

Example: Coinbase/GDAX is a company that provides a digital currency exchange and cryptocurrency wallets, and is often considered one of the top exchanges in the United States.¹² In the last two years, there have been 2,768 complaints filed with the CFPB about Coinbase.¹³ The most common complaints discuss problems withdrawing funds, account closures, transaction errors, and an overall inability to speak with customer service to fix any problems that occur when using Coinbase.

¹⁵Shifflett, S. & Jounes, C. (2018). Buyer Beware: Hundreds of Bitcoin Wannabes Show Hallmarks of Fraud. Retrieved December 17, 2018 from: <https://www.wsj.com/articles/buyer-beware-hundreds-of-bitcoin-wannabes-show-hallmarks-of-fraud-1526573115>

¹⁶Frauenfelder, M. (2017). I Forgot My Pin: An Epic Tale of Losing \$30,000 in Bitcoin. Retrieved January 25, 2019 from: <https://www.wired.com/story/i-forgot-my-pin-an-epic-tale-of-losing-dollar30000-in-bitcoin/>

¹⁷Russolillo, S. & Jeong, E. (2018). Cryptocurrency Exchanges Are Getting Hacked Because It's Easy. Retrieved January 25, 2019 from: <https://www.wsj.com/articles/why-cryptocurrency-exchange-hacks-keep-happening-1531656000>; linuma, A. (2018). Cryptocurrency: How to Avoid Getting Hacked. Retrieved January 25, 2019

POLICY RECOMMENDATIONS



ENFORCE & STRENGTHEN

Existing Financial Consumer Protection Laws



REJECT “SANDBOX” PROPOSALS

which Create Consumer Protection Deserts

Enforce & Strengthen Existing Financial Consumer Protection Laws

While the fintech industry claims to be offering new and innovative products, these products are existing financial products repackaged with a new delivery method. A student loan remains a student loan, whether a person received it by applying in person at a bank or online via a web portal. When trying to evaluate the benefit of a fintech product, people should look beyond the fancy website or streamlined app to the underlying financial transaction.

Regulators and legislators should also use this lens when examining fintech products and determining what regulations they should be subject to. State laws already exist to regulate the underlying financial transactions of fintech products, so legislators do not need to create brand new laws to regulate fintech.

Rather than creating new laws, legislators should ensure that existing consumer protection laws are updated as needed to address any new issues that arise because of technological changes. Although the financial products are not new, the technology used in delivery may be, and legislation should be updated to reflect changes in delivery mechanisms. Further, some fintech companies are currently using technology to evade state laws, which means laws should be strengthened and loopholes should be closed to ensure that any company that offers a financial product to an Illinois resident is subject to Illinois state laws.

be, and laws should be updated to reflect changes in delivery mechanisms. Further, some fintech companies are currently using technology to evade state laws, which means that existing laws should be more strongly enforced, and when necessary, laws should be strengthened and loopholes should be closed to ensure that any company that offers a financial product to an Illinois resident is subject to Illinois state laws.

Finally, regulators should examine the underlying financial transaction to determine what laws the fintech product is subject to, and enforce those laws as applicable. Regulators should also work with fintech companies to help them fully comply with applicable laws and regulations.

Reject “Sandbox” Proposals, which Create Consumer Protection Deserts

Legislators and regulators should reject fintech “sandbox” proposals, where consumer protection laws are waived for companies to test an “innovative” financial product or service. This creates a consumer protection desert, where consumers bear all of the risk, and companies can cause real harm. For instance, most sandbox proposals have no mechanism for restitution – so if a consumer loses money to a company participating in a sandbox, there is no opportunity for recourse.

Sandboxes allow predatory lenders and companies an opportunity to skirt existing laws. Arizona is the first and only state to create a sandbox, which they established in 2018. One of the first companies approved was an online title lender, which is now exempt from meeting the licensing requirements that provide protection for consumers.

Instead of creating regulation deserts where fintech companies are allowed to benefit at the expense of consumers, regulators should work closely with fintech companies to help them navigate the regulations for their products.

While fintech has been advertised as an opportunity to increase access to safe, quality financial services for individuals who have traditionally been excluded from financial institutions, this is by no means the guaranteed outcome of fintech. Without adequate regulation and oversight, fintech simply serves as a new delivery mechanism for financial services and products that have historically excluded communities and stripped wealth from people of color. Innovation, in any form, does not automatically strengthen consumers’ financial security or guarantee that products will promote equity and reduce the racial wealth divide. It is crucial that legislators, regulators, and advocates ensure there is adequate regulation and oversight for fintech companies to make sure that the potential benefits, instead of the harms, of fintech are realized for Illinoisans.

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