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MONEY

Employers Should Be Leery of Workplace Loans

BY JEREMY QUITTNER

Helping out an employee in need of a short-term loan can seem like kindness--until you start charging them.

The uptake of on-the-job loans among employees has mounted in recent years, as nonbank, third-party providers set their sights on the workplace. But for employers, getting into the lending business isn't for the faint of heart.

Almost every small business lends money to an employee at some time, and research indicates that such loans can increase loyalty and build bonds between workers and owners. At the same time, these loans can be subject to additional income taxes, and they can also open up a business to discrimination lawsuits, experts say.

Buyer Beware

But if you still consider these, proceed with caution and perform due diligence, as the service could easily morph into a modern-day version of the company store.

While such third-party services assume the tax and legal risks, they have earned a comparison to payday lenders, the pariahs of the lending community which often charge interest rates of 500 percent or higher. Though the rates workplace loan providers charge are much lower than payday lenders, employees can still get caught up in an unending cycle of debt.

"Is it fair for an employer to get the services of the worker, and the lender to take his money? At what point is this unconscionable," says Robert Wood, a tax attorney for Wood LLP in San Francisco.

More than just loans, financial wellness too

Some providers, like Emerge Workplace Solutions, an employee lending concern in Nashville, Tenn., come in the guise of financial wellness programs. Emerge contracts independently with banks and credit unions for financing, and then works with employers to debit monthly amounts from employee checks until the loans are paid back. Interest rates are still high, but are generally less than half of their payday counterparts. Employers don't profit from the loans.

"Financial stress is costly to all employers, and 70 percent of employees live paycheck to paycheck," says Jonathan Harrison, founder and chief program officer of Emerge.

Emerge performs a financial "health" assessment of every employee looking for financing, and uses that information to determine conditions of the loan such as the annual percentage rate, which generally ranges between 8 percent and 18 percent, plus a $30 fee for the transaction. That comes to an equivalent annual interest rate of around 36 percent, Harrison says. Loans average about $1,000.

Access to bank accounts and financial counseling

In addition to loans, Emerge offers ongoing financial counseling to employees, helps them set financial goals, and if they don’t have one--a primary reason workers use high fee non-bank financial providers like cash checking agencies--give them access to a bank account from which their monthly payment is debited. They can't borrow again until the loan is paid off and a subsequent credit analysis shows the employee is not racking up debts elsewhere.

(Other providers include Fairloan and Think Finance. Fairloan did not respond to a request for comment, and a representative from Think Finance said no one was available to comment.)

Not everyone's onboard, however, and many financial experts say small business owners should generally distance themselves from the financial lives of their employees.

"This is ripe for problems and puts the employer in the middle," says Scott Cheslowitz a partner at tax firm Rothenberg & Peters, of Great Neck, New York.

Potential difficulties abound

The potential problems could include loan defaults, or breeding ill will between the employer and employee, as well as questions of what happens to the debt if the employee leaves before paying off the loan.

The responsibility for making sure employees understand the financial disclosures may also become the employer's, who also becomes the unwitting endorser for the third party's loan product.

"I can understand why a business might want to offer a loan for loyalty, but are these loans a benefit or a burden?" Wood says.

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