

# **Fringe Banking in Winnipeg's North End**

Jerry Buckland, PhD. and Thibault Martin, PhD.

with

Brendan Reimer, Nancy Barbour,  
Amelia Curran & Rana McDonald

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Winnipeg Inner-city Research Alliance



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# FRINGE BANKING IN WINNIPEG'S NORTH END

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## Introduction

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### 1.1 Context of Research Topic

*I use [a Cheque-Cashing Firm] to cash cheques and get money orders. My bank places a hold on my cheque for five days. At the cheque-cashing facility I get my money right away. There is no extra paperwork there, either. It's just more convenient.*

—A client of a cheque-cashing firm

*We [pawnbrokers] provide a service.... People won't pay [for the service] if the price is too high. Compare our profit with, for example, Robin's Donuts. We expect a [fair return] on investment.*

—A pawnbroker

The two quotations<sup>1</sup> above come from research conducted from September 2002 through August 2003 with clients and owners/managers of fringe banks and other key informants. The comments point to the mixture of motives involved with the rise of fringe banking in Winnipeg's North End. The research study explored why fringe banks are growing in numbers and types when they charge higher fees for services than do mainstream banks. We focussed particularly on understanding why clients use these services and whether fringe banks earn excessive profits. This section of the report introduces contrasting views on the legiti-

macy of fringe financial services, outlines results from recent studies on fringe banking in Canada and the US, and describes the research objectives and research methods of this study.

Fringe financial service firms, or "fringe banks,"<sup>2</sup> are a growing phenomenon in Winnipeg and to varying degrees throughout Canada, the US, and the UK. This industry includes pawnshops, cheque-cashing firms, payday loan firms, and rent-to-owns, and more broadly can also include finance and loan companies. These fringe banks provide fringe financial services, which include cashing cheques, loans, money orders, and rent-to-own agreements. While pawnbroking is an historic institution, other fringe banks are newer entrants into the market for financial services. That is not to say that the services these newer fringe banks provide are new. Retailers have cashed cheques for many years and some have offered rent-to-own agreements in the past. What is new is the establishment of firms exclusively concerned with a certain type of financial service: cashing cheques, payday loans, and rent-to-own agreements. These financial services generally provide some sort of loan that is relatively small and costly when compared to the credit available from banks, credit unions,

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1 Quotations are based on information recorded during interviews. They may be written verbatim or paraphrased.

2 The name for this industry is fairly new because of its rapid and recent rise. The term "fringe banks" seems to be well accepted in the US where most of these firms, excepting pawnshops, have their longest history (see Caskey 1994). In Canada "fringe" (see Public Interest Advocacy Centre 2002) and "alternative" (see Ramsey 2000) are adjectives used to describe this financial sector. "Fringe financial service firm" or "fringe bank" are used in this study because US and some Canadian research has established this as an effective name. The terms are intended to describe a variety of firms that operate on the margin of the financial system—they are not intended to judge the firms or clients. Caskey (p. 106) notes that another set of fringe banks, in this case associated with the high-income margin of the financial system, has also experienced recent growth in the US.

and credit card companies. The clientele of fringe financial services tends to be low-income people.

The dependence of low-income people on fringe banks has generated concern regarding the rise of fringe financial services. From an anti-poverty perspective, voiced by community development practitioners, these services further impoverish low-income people. Pawnshop loans and expensive cheque-cashing are the only options for a low-income person—particularly as mainstream banks close their branches in the inner cities. The service charges for the loan or cashed cheque eat into a limited budget and compound the debt-poverty cycle often faced by a low-income person. A pawn loan allows a person to meet a daily need or want today, but repaying the loan and interest in one month reduces their income at that time. If money is especially tight, the person may require an additional loan or extension to maintain the payments on the previous loan. This increases economic and psychological strain on the low-income person, leading to a further deterioration of the person's economic and social well-being.

On the other hand, from a market perspective, the rise of fringe banking represents the growth of innovative, new financial services previously unavailable. Financial sector liberalization—i.e., reduced regulations and national protection—and the development of new technologies—i.e., communications and information processing—have generated new services and firms. These processes are associated

with the recent deepening of economic globalization reflected in international and regional trade agreements. The result, according to industry proponents, is that these services and firms can meet the needs of a particular set of consumers in a way that, for instance, mainstream banks have previously been unable to do. The case for pawnshop loans is somewhat different, given its long history. That said, industry proponents argue that pawn loans are an efficient way to provide credit to people with little or no collateral.

The idea for this study originated with several community-oriented organizations primarily based in the North End<sup>3</sup>, an inner-city neighbourhood in Winnipeg. These community organizations are committed to anti-poverty work in general and particularly address the difficult economic situation faced by inner-city and North End Winnipeg residents. The organizations are involved in a number of programs, from micro-enterprise development through “asset-building” (individual savings) programs to general neighbourhood revitalization. They are also actively engaged in dialogue with policy-makers and politicians, and are connected to the academic community through various research projects. These agencies reflect both pragmatic and radical perspectives on poverty and community development, sharing a concern for the local area and addressing poverty issues, but they differ in their understanding about the fundamental causes of, and solutions to, poverty. The pragmatic approach accents economic and social causes of poverty, and sees solutions in

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3 The “North End” refers to what used to be the northern quadrant of the city of Winnipeg. The term continues to be used for this area even though it is now situated in the core area of Winnipeg—the inner city. The geographic boundaries of the North End, as determined by the North End Community Renewal Corporation, is north of the CPR tracks, south of Caruthers Avenue, east of McPhillips Street, and west of the Red River. The city neighbourhoods included in this definition of the North End include: Burrows Central, Dufferin, Dufferin Industrial, Inkster Faraday, Lord Selkirk Park, Luxton, North Point Douglas, Robertson, St. John's, St. John's Park, and William Whyte.

bridging the social and economic barriers. Radical analysis accents the political causes of poverty and searches for political solutions. Both these views are found within the organizations that identified the fringe bank as an important issue in the North End. The idea for this research study is one outcome of these groups' efforts.

## 1.2 Studies of Fringe Banking

The literature on fringe financial services is limited, particularly in Canada. Scholarly examination of fringe financial service firms in the US grew in the 1990s (Caskey 1991, p. 85). The following data point to the recent growth and current significance of pawnshops, cheque-cashers and payday loan firms in Canada.<sup>4</sup>

Based on a small-scale household survey undertaken by the Public Interest Advocacy Centre (PIAC) in 2002 (pp. 34-35), almost 200,000 Canadians had used a pawnshop service and between 1–1.4 million Canadians had used some type of fringe banking service in the last three years. Ramsey (2000, p. 11) found the largest number of pawnbrokers across Canada in Quebec, followed by British Columbia, Alberta, and Ontario. Money Mart, the largest payday loan and cheque-cashing firm in Canada, claimed to have established 254 outlets by 2002. The PIAC study estimated that approximately 550,000 Canadians had used a cheque-cashing or payday loan service in the last three years. However, Ramsey reported

that the 1998 research study for the Financial Services Task Force found that 8% of the Canadian population (approximately 2.4 million) had used a cheque-cashing firm's service. Ramsey notes the highest number of cheque-cashing firms per capita in Canada is in British Columbia, followed by Alberta and Ontario. Quebec had a low per-capita number of cheque-cashing firms. Caskey (1994, p. 64) estimated that in 1990, US cheque-cashing firms cashed 128 million cheques with a combined value of \$38 billion, earning the industry \$700 million in fees.

Fringe bank clients come from a variety of socio-economic backgrounds. However, clients of some fringe banks, particularly pawnshops and cheque-cashing firms, are generally characterized by low income and limited access to mainstream banks. The PIAC survey supported this view regarding pawnshop clients. Payday loans are another matter. The PIAC study commented that broadly defined fringe financial services, including the previously mentioned firms plus finance companies, loan brokers, and tax rebate discounters, are not used predominantly by low-income people. PIAC estimated that only 15% of the consumers within this broadly defined fringe banking market would fall below Statistics Canada's low-income cut-off.

Studies confirm that fringe financial services are relatively expensive. Annualized interest rates of 100–500% are common, and one estimate found that

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4 The number of pawnshops in the US has increased to between 9,000 and 13,000 (Caskey 1994, p.47; Johnson and Johnson 1998, p. 7). It is estimated that in 1988, US pawnshop credit reached \$689 million, less than 1% of total US consumer credit. At that time there were roughly one-half as many pawnshops as today, suggesting that pawn loans may have reached closer to 2% of total consumer credit in the US. The number of cheque-cashing outlets in the US grew from approximately 2,000 in 1986 to 5,500 in 1997, reaching 11,000 in 2002 (Squires and O'Connor 2001, p. 142; Lynch 2002, p. 3). The number of payday loan firms in the US in 2001 is estimated at 8,000–10,000 (Elliehausen and Lawrence 2001, p. iv; Lott and Grant 2002, p. 12). Note that there is some overlap between payday loan firms and cheque-cashing firms, so that the total number of cheque-cashing firms and payday loan outlets in the US would be less than 19,000.

payday loans' annualized interest rates amounted to 3000% (Lewison 1999, p. 3). At the same time, many studies have found that clients use fringe banks because of convenience related to hours of operation, proximity, and quick service (Squires and O'Connor 2001, p. 154). This report provides further evidence about both these issues.

In terms of explaining the growth of fringe banking, various factors, falling into roughly two categories, have been identified in Canadian and US studies.<sup>5</sup> On the supply side of the fringe bank equation, various factors influence the supply of mainstream and fringe bank services, especially changing financial sector regulations, which are connected to broad processes such as financial sector liberalization and technological change. On the demand side, several factors influence peoples' demand for mainstream and fringe bank services, including stagnant incomes at low levels, growing debt ratios, declining state interventions and racial discrimination.

Ramsey (2000, p. 2) points out that between 650,000 and 900,000 adults do not have a bank account and that 8% of households with incomes less than \$25,000 do not have bank accounts. This varies considerably across the country: households in Quebec, with its extensive *caisse populaire* system, have better access to mainstream banks. Ramsey comments that the decline in small, unsecured loans, due to the development of credit cards

and lines of credit, is a factor in the rise of fringe banking. He points to rising debt-to-income ratios among Canadians in general—and low-income people in particular—lower rates of savings, racial discrimination, and rising income inequality in Canada as explanatory factors on the demand side of the fringe bank equation. The debt-to-disposable-income ratio for Canadians rose on average from 78% in 1992 to 100% in 1998. The PIAC (2002, p. 38) study, drawing on fringe bank clients' perceptions of their economic circumstances, found that only pawnshop clients perceived their debt levels to be higher than the average. This is not surprising, considering that average debt load has been rising.

### 1.3 Research Goals and Methods

The research project involved three major goals but two are highlighted in this report.<sup>6</sup> The first goal was to examine the services, fees, and growth of fringe financial services in the North End. The second goal was to explore why clients use fringe financial services. Several research methods were used, including key informant interviews, sample transactions and outlet follow-up, client questionnaire, and focus-group discussions. This research was primarily undertaken from September 2002 through July 2003.

Our first objective was to explore the basic economics of the fringe financial sector to determine whether the sector overcharges low-income customers. This

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5 In his examination of fringe banking in the US, Caskey (1994, p. 84) argues that a chief reason for their rise is the increase in the number of households without bank accounts, rising from 9.5% of the US population in 1977 to 13.5% in 1989, the result of processes affecting banks (supply side) and bank clients (demand side). On the supply side of the equation, Caskey argues that changing bank regulations have led to the introduction of bank fees and the closure of bank branches in low-income neighbourhoods, which has reduced accessibility of bank accounts. On the demand side of the equation, bank clients and potential clients have faced pressures that discourage holding a bank account. Caskey points to several factors here, including the stagnant or declining real incomes of low-income people, an increase in the number of people falling below the poverty line, and reduced savings rates. Other factors associated with the rise of fringe banking include: the rise in consumer



research involved a series of key informant interviews, sample transactions, and some outlet follow-up. Key informants were purposely selected based on their special understanding of fringe banks and fringe bank customers. This included informants from the fringe financial sector, community agencies, banks and credit unions, and government. A total of 27 key informant interviews were undertaken during the fall and winter 2002-2003. The key informants were asked a subset of the questions contained in the key informant schedule, which addressed the size, profitability, and motivations of the fringe financial sector as well as the scope for community-based alternatives.

For some fringe financial services, there was insufficient secondary and key informant data. In these cases, it was necessary to run sample transactions and do some outlet follow-up to determine the procedures, costs, and benefits. One sample transaction was undertaken with a fringe financial service firm in the North End and, once it was completed, we informed the firm in writing about it and our results. Particularly in the case of cheque-cashing and payday loan firms who refused to participate in the key informant study, additional data were collected through outlet follow-up. This included telephone calls or in-person visits to determine services, costs, and procedures.

The second goal of this research was to explore the sociological and political reasons for consumer interest in fringe

banks. We wanted to understand fringe bank client experiences and motivations. This field research involved a survey of 41 North End adult (at least 18 years of age) clients of fringe financial services.

To select respondents, we used the “chain referral” sampling method. To ensure fair gender representation, at least one-half of the respondents were female. We made initial contacts through personal connections (with our community researchers), by talking with clients outside the fringe financial firm’s outlet, and through flyers and posters distributed around the North End. These contacts were interviewed and asked to refer other clients for the interview, and so on. Arrangements were made to interview most of the clients over a four-week period in the offices of two sponsoring non-profit organizations. The clients were asked a series of questions outlined in the client questionnaire. These questions relate to the client’s use, and their motivations for the use, of fringe financial services. We asked clients to discuss their interest and ideas about community-based alternatives to fringe financial services. Respondents were compensated for child care, travel, and incidental costs at a rate of \$20 per interview.

Two focus group discussions supplemented the research. One focus group, which included fringe bank clients, further explored their experiences with fringe banks and their ideas about alternatives to fringe banks. The second focus

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credit risk related to high levels of debt-servicing and personal bankruptcy; the contraction in the bank and finance company supply of non-revolving, unsecured loans; the growing numbers of people with higher credit risk due to increased legal and illegal immigration to the US; the increase in gold prices; the growing awareness among entrepreneurs of the profits in fringe banking, and the growing demand by consumers for instant credit .

6 A third goal of the research was to develop a preliminary model and feasibility assessment of a community-based centre that would offer a combination of financial services. This is reported on in the original report published by the Winnipeg Inner-city Research Alliance, “The Rise of Fringe Financial Services in Winnipeg’s North End: Client Experiences, Firm Legitimacy & Community-based Alternatives.” Available: [http://ius.uwinnipeg.ca/wira\\_whats\\_new.html](http://ius.uwinnipeg.ca/wira_whats_new.html).

group involved community organization key informants, who helped to develop a model that formed the basis of the feasibility assessment.

#### **1.4 Outline of the Report**

This report is composed of five sections. The first section considers the general disadvantaged situation in the North End, and examines the services, fees, and the rise of fringe banks in the North End and Winnipeg in general. The second section reports on the survey of fringe bank cli-

ents in Winnipeg's North End and analyzes fringe bank clients' experiences with fringe and mainstream banks. The third section reports on the key informant survey that addresses, among other points, the question of fringe bank legitimacy. The next section of the report summarizes a series of models across Canada that strive in various ways to provide a community-oriented alternative to fringe financial services. The report ends with a summary and presentation of a series of recommendations developed by the research team.

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## Winnipeg's North End and Fringe Financial Services

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### 2.1 Winnipeg's North End

Winnipeg's North End, with a population of 17,295 people in 11 neighbourhoods, is a relatively disadvantaged area. This is particularly the case in the southern portions centred around Selkirk Avenue and Salter Street that contain six neighbourhoods: Burrows Central, Dufferin, Dufferin Industrial, Lord Selkirk Park, North Point Douglas, St. John's, St. John's Park, Robertson, and William Whyte. This section describes this disadvantage by reporting on the key social and economic indicators for households within Winnipeg's North End.<sup>7</sup> North End data on income, employment levels, ethnicity, family structure, education levels, and access to transportation are compared with data for the rest of Winnipeg.<sup>8</sup>

Income level, employment type, and level of dependence on social assistance are key factors that determine the socio-economic status of households. Family structure, ethnicity, education level, age, and means of transportation are also related to social and economic status. An examination of these indicators in the North End shows that this community has a rela-

tively low economic and social status when compared to the rest of Winnipeg, indicating high levels of poverty and significant levels of social disadvantage.

The average household income in the North End is \$22,320 (Table 2.1). This is 50% lower than the Winnipeg averages of \$44,937. Within the North End, the lowest income levels are found in Lord Selkirk Park with the average of \$16,513. Moreover, within the North End, the incidence of households below the low-income cut-off is 64%—compared with a city-wide average of 24%. Since income, employment, and social assistance levels tend to be related, it is no surprise that unemployment and social assistance levels are relatively high in the North End. In total, the unemployment rate in the North End is 23%—compared with a city-wide average of 8%. In the area of social assistance, 43.1% of North End households receive government transfer payments,<sup>9</sup> which is much higher than the Winnipeg average of 13.9%.

The North End contains a proportionately high fraction of young people. Also,

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7 This demographic information of Winnipeg's North End is composed of statistical information, based on the 1996 Census Data found on the City of Winnipeg web site [[www.city.winnipeg.mb.ca/interhom/about\\_winnipeg/profile/census.stm](http://www.city.winnipeg.mb.ca/interhom/about_winnipeg/profile/census.stm)]. The "Winnipeg's Neighbourhood Profiles" are based on the category of Non-Institutional Population and 20% sampling, as provided by Statistics Canada. This means the data do not include people living in hospitals, nursing homes, prisons, etc.. As well, one in five dwellings was surveyed; these results were then multiplied by five to arrive at representative data for the whole community. Only the "Total Population" data are based on the results of surveying all the dwellings and including all the population, both non-institutional and institutional (City of Winnipeg, 2003).

8 The statistics for Winnipeg include all the individual areas/communities and include the areas to which they are being compared.

9 "Government transfer payments" refers to: Old Age Security, Guaranteed Income Supplement, Canadian Pension Plan, Unemployment Insurance, Federal Child Tax Benefit, and other income from government sources—federal, provincial, and municipal (Statistics Canada 1996).

**Table 2.1 Social and Economic Indicators of Winnipeg's North End**

	Average		Difference
	North End	City of Winnipeg	North End & Winnipeg
Average annual household income	\$22,320	\$44,937	-49.60%
Households below the low-income cut off	64.0%	24.0%	40.0%
Unemployment rate	23.0%	8.0%	15.0%
Government payment transfer recipients	43.1%	13.9%	29.2%
Population under the age of 15	24.9%	20.2%	4.7%
Single-parent families	47.4%	25.4%	22.0%
Self-identified Aboriginal population	31.1%	7.1%	24.0%
Visible minority population	16.5%	11.9%	4.6%
Non-attainment of grade 12 graduation	61.2%	35.0%	26.2%
Drives a vehicle as mode of transportation	50.9%	66.6%	-15.7%
Public transit as mode of transportation	23.2%	15.5%	7.7%

some neighbourhoods—specifically Lord Selkirk Park—contain a relatively high number of people at retirement age. These two factors are important, since they indicate the levels of economic dependency. In the North End, 24.9% of the population are 14 years of age or younger (Table 2.1). In Lord Selkirk Park, the numbers reach 28%. However, in Winnipeg as a whole, only 20.2% of the population are below 15 years of age. Winnipeg and the North End both have around 13.5% of their population over the age of retirement. However, in Lord Selkirk Park, the proportion of people at retirement age is much higher at 15.2%.

The types of family structures also relate to socio-economic status. For instance, household income can be directly related to the number of income earners contributing to the family. Typically, the higher the number of people contributing income to a household, the greater the likelihood of a higher household income. Single parenthood is a relatively common occurrence in the North End. While the percentage of families headed by a single parent in Winnipeg is 25.4%, single-parent families make up 47.4% of the total in the focus community. This is important because

single parents, specifically women, are more likely to experience poverty.

Race and ethnic diversity, which contributes to the uniqueness of an area, is also a factor on which income depends. The North End contains a large self-identified Aboriginal population at 31.1%. Winnipeg as a whole is only 7.1% Aboriginal. Visible minorities, which make up 16.5% of the population of the North End, comprise a smaller percentage at 11.9% of the population of Winnipeg.

The attainment of formal education is strongly linked to socio-economic status. When comparing people 15 years or older, the levels of education are much lower in the North End than in the rest of Winnipeg. Those who have not achieved a secondary certificate make up 61.2% of the population in the North End. This is substantially higher than the 35% average in the rest of Winnipeg.

While the mode of transportation used by a household does not determine the socio-economic status of that household, it is often reflective of the socio-economic status of a community. Mode of transportation is also of specific interest in this

study in relation to bank locations. In the North End, people are much more likely to walk, bike, or use public transportation than in the rest of Winnipeg. They are also 15.7% less likely to drive a car, truck, or van. This dynamic makes accessing remote bank locations much more difficult for residents of the North End in comparison to other residents of Winnipeg.

The North End is a relatively disadvantaged area in Winnipeg. This is reflected in, among other factors, average income, unemployment rates, and dependence on social assistance. The data on disadvantage are more acute in the southern neighbourhoods of the North End, which are considered a part of Winnipeg's inner city. With a more disadvantaged economic situation, North End residents are arguably in a more precarious financial situation.

## 2.2 Fringe Banks in Winnipeg and the North End

This section describes the fringe financial service firms in Winnipeg and the North End. It presents data on the rise of fringe bankers over the last 20 years, focussing on pawnshops, cheque-cashing firms, payday loan firms, rent-to-own firms, and tax-refund advancers. The section provides some information on the fringe bankers' perception of their customers' characteristics and also explains the types

of services these firms offer and the associated costs.

The data for this section come from key informant interviews, a sample transaction, outlet follow-up, and various secondary sources (e.g., fringe and mainstream bank flyers, pamphlets, Web sites and the Winnipeg telephone directories). In the case of cheque-cashing and payday loan firms, data were primarily drawn from outlet follow-up that involved telephone calls or in-person visits, which were necessary because of these firms' low participation in the key informant survey.<sup>10</sup>

In all types of fringe banks, the costs for financial services are expressed as a lump-sum fee and an annualized interest rate. Both these methods combine various fees for the service into one figure.<sup>11</sup> How the costs for fringe financial services are expressed is controversial. Proponents of fringe banks, most notably payday loan services, argue that since these loans are for only two weeks, it makes sense to consider the absolute cost of the service (Elliehausen and Lawrence, 2001). Accordingly, the high fees represent the cost of providing risky and labour-intensive loans. However, some argue that fringe bank services should be compared with mainstream bank services where the principal cost of services such as loans, credit cards, and lines of credit is the (annual) interest rate. The loans implicit in pawn-

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10 The research team documented the efforts we took to interview cheque-cashing and payday loan firms in Winnipeg. In addition, we emailed and telephoned firms with headquarters outside Winnipeg. Finally, we advertised in a local newspaper about the research study and called for participation from employees of cheque-cashing and payday loan firms.

11 The Consumer Measures Committee, a partnership of federal, provincial, and territorial government departments, is seeking to develop common policies regarding the "alternative consumer credit market"; i.e., fringe financial services. In 1998 they completed a paper, "Agreement for Harmonization of Cost of Credit Disclosure Laws in Canada: Drafting Template." The paper proposes that fringe banks provide consistent information about their services to consumers in part by combining all fees into a lump-sum total cost and then converting this into an annualized interest rate. The fees include "interest; administrative charges such as service, transaction, and activity charges; charges for the services of a notary or lawyer hired by the lender and payable by the borrower; charges for loan insurance ... [and] brokerage fees ..." (p. 8).

ing, cheque-cashing, payday loans, rent-to-owning, and tax-refund advancing<sup>12</sup> should be valued using the same measure. There are good reasons to follow the approach of annualized interest rates. Most mainstream banks provide short-term credit through credit cards and lines of credit in which interest rates are expressed in an annualized form. Therefore, in this study, fringe financial service fees will be combined together and transformed into an annualized interest rate for comparative analysis.<sup>13</sup>

### 2.3 Pawnshops: Traditional Fringe Bankers

Unlike cheque-cashing and payday loan firms, pawnshops have a long tradition in the West and around the world.<sup>14</sup> Pawning is a unique system that provides a small, secured loan for a fee. Pawnshop clientele are primarily low-income individuals who do not have access to other forms of credit.

In 1987 there were 23 pawnbrokers in Winnipeg, increasing to 38 pawnshops in 1988 and dropping to 31 in 1989. The number of licensed pawnshops in Winnipeg has stabilized from 1989 to 2002 at around 30. Today there are 32 pawnshops licensed by the city and they are primarily scattered throughout Winnipeg's inner city. According to one respondent, the

first recent-day pawnshop was established in the North End in 1980. The number of pawnshops in the North End grew to five in 1987 and reached nine at the time of this report.<sup>15</sup>

Pawning involves a simple relationship designed to facilitate a cash loan. It works as follows: the borrower deposits a resaleable item such as electronics or jewellery with a pawnbroker. The broker advances the depositor a loan, worth less than the resale value of the deposited item. In Winnipeg, the pawn is made for one month but may be redeemed after 15 days, at which time the depositor repays the loan plus pays other fees. If the loan is defaulted, the broker sells the deposited item. Pawnshops can also operate as second-hand sellers, although our respondents indicated that most of their transactions were pawning. We are aware of three pawnshops that also offer limited cheque-cashing services.

Key informants were asked about the financial nature of their businesses. Although they were unwilling to share detailed information, we were able to develop a basic understanding of the businesses. These pawnshops are locally owned, independent businesses. There appears to be some market concentration in the pawnbroking sector, as one or two pawnbrokers control several pawnshops.

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12 Other fringe bankers such as finance companies, white-label automatic teller machines, and money orders are not examined here.

13 For this study the annualized interest rate is calculated in the following manner. First, all fees associated with the transaction are a combined into a lump-sum total cost for the service (see footnote #1). The period interest rate is the total lump-sum cost divided by the value of the loan. The annualized interest rate is the period percentage rate multiplied by the number of periods in one year. For instance, a pawnshop loan of \$10 for one month involves various fees amounting to \$4.50 in total. The one-month (period) interest rate =  $\$4.50/\$10.00 = 0.45 = 45\%$ . The annualized interest rate =  $45\%/month \times 12 months/year = 540\%$ .

14 For a brief historical review of pawnshops and other fringe banks in the US, see Caskey (1994). For a more in-depth look at social perceptions of pawnbrokers over time in Europe and North America, see Lewison (1999). For an examination of pawnbroking in the south (or developing world), see Bouman and Houtman (1988) and Bouman and Bastiaanssen (1992).

15 During the research project, an application was submitted to the city's licensing department to establish a new pawnshop in the North End. The application was not approved.

According to the police respondent, there were 8,750 pawn transactions per month in Winnipeg last year. Evenly spread over the 32 pawnshops, this amounts to a monthly total of 273 per pawnshop. In fact, two pawnshop respondents indicated transactions of 500 and 700 per month, suggesting a variation in the size among pawnshops. With a monthly average of 600 pawn transactions, these two respondents claimed they averaged an additional 300 pawn extensions each month. (An extension is when the borrower requests an additional month to repay the loan.) Just over three-quarters of all pawns are eventually redeemed, according to these respondents.

Most pawnbroker respondents were unwilling to provide information on their income and profits, and therefore we cannot comment on the overall profitability of pawnshops. However, one respondent provided data suggesting a very good return on equity at approximately 60% in one year.

The pawnbrokers thought the majority of their customers were from the locale. According to pawnbroker respondents, 90% of their clients are from their neighbourhood, 50% had an ongoing relationship with the pawnshop, 57% are from an Aboriginal background, and 53% are male.

According to our respondents, the value of the average pawn is just over \$50. The cost to redeem the pawn depends on the value of the pawn, with higher per-dollar costs for lower pawns. The redemption cost generally includes an interest charge plus storage and insurance charges. The interest charge is generally 5% per month, amounting to 60% per year. However, when the storage and insurance charges are rolled into the interest charges, the annualized interest rates are higher. On average, annualized interest charges for a larger pawn of between \$50 to \$100 are 300%. Annualized interest rates on smaller pawns of between \$10 to \$30 are 450% (Table 2.2).

**Table 2.2 Fringe Financial Service Costs**

Financial Service	Costs		
	Value of Loan/ Cheque/Item/ Refund	Lump Sum (\$) Average (Range)	Annualized Interest Rate (%) Average (Range)
Pawn	\$50—\$100	20 (15-25)	300 (240-360)
“	\$10—\$30	5.20 (2-9)	450 (240-540)
Cash cheque*	\$100	4.04 (2.00-4.98)	210 (104-259)
Payday loan	\$100	26 (18-38)	675 (468-988)
“	\$200	33 (20-50)	551 (260-650)
“	\$300	63 (30-75.70)	546 (260-656)
Rent-to-own	\$691 retail price	475 (216-734)	305 (120-489)
Tax refund advance**	\$500 refund	55	286

Source: Key Informant Interviews and Outlet Follow-up

\*Considered to be a short-term loan as it provides an instant alternative to the mainstream banking practice of placing a five-day hold on cheques

\*\*Excludes cost for income tax preparation and cheque-cashing

## 2.4 Cheque-cashing and Payday Loan Firms: The New Fringe Bankers

Cashing a cheque outside a mainstream financial institution is an old practice, although not as old as pawning. Through our client survey, we found that cheques are cashed at local stores, bars, and pawnshops in the North End. However, in the last 20 years, a new type of fringe bank has arisen that deals centrally in cheque-cashing and/or payday loans. Whereas the corner store will cash a cheque in order to facilitate the purchase of its merchandise, the cheque-cashing firm's business is cashing cheques. As mentioned above, with one exception, this category of firm was unwilling to be interviewed for this research. The one cheque-cashing/payday loan respondent claimed that the cheque-cashing portion of the business is declining and the payday loan portion is increasing, a trend attributed by this respondent to the rise of directly deposited payments.

While the number of pawnshops in Winnipeg and the North End grew through the 1980s, the number of cheque-cashing and payday loan firms has grown in the 1990s and 2000s. The first listing of cheque-cashing firms in the Winnipeg telephone directory was in 1985, when there were two outlets (from one firm). This increased to four outlets in 1988, to six outlets in 1999, and to 10 outlets in 2003. The first payday loan firm listing in the telephone directory was in 2000 (when there were three outlets listed). Growth spiked to 25 outlets in 2002 and 33 outlets in 2003. Part of this increase is due to the fact that in 2001 the largest cheque-cashing firm began listing itself under the payday loan category as well.

There is considerable market concentration in the cheque-cashing and payday loan business in Winnipeg. In 2003, 11 firms controlled these 33 outlets. Two firms, Money Mart and Instaloans, con-

trol nine and eight outlets, respectively, representing one-half the total outlets. The remaining 16 outlets are held by nine firms, with some firms owning three or four outlets, including The Cash Store and Sorenson's Loans. According to a key informant, there are 11 payday loan outlets in other parts of Manitoba. The two cheque-cashing firms in Winnipeg, presently involving 10 branches, are owned by larger corporate entities. In the case of Financial Stop, H & R Block is the owner. Dollar Financial Group, a US corporation with operations in the US and UK, owns Money Mart. Financial Stop has reduced their outlets from three to one in 2003.

The situation in the North End mirrors, at a lower scale, the situation in Winnipeg. In the North End, one cheque-cashing firm has operated continuously since 1988, and now there are two. Payday loan firms first appeared in 2002, and today there are five outlets, two located in the heart of the North End near Selkirk Avenue and Salter Street.

The name "cheque-cashing" is self-explanatory. Providing the cheque-cashing firm with a third-party cheque with adequate personal identification and a fee, the client is able to obtain immediate cash. The immediate conversion to cash is attractive in comparison to the mainstream banks' practice of a five-day hold on cheques. In addition, mainstream banks generally have tighter identification requirements than the cheque-cashing firm. For instance, in the North End, the personal identification requirements range from two pieces of photo-identification to, as a respondent reported, "whatever you have." Fees for cheque-cashing range significantly, generally including a per-cheque fee and a percentage of the cheque's value. One cheque-cashing firm respondent clearly posts its cheque-cashing fees, but others do not.



The costs of fringe financial services can be generalized into a lump-sum fee or an annualized interest rate. To cash a \$100 cheque, fees ranged from \$2.00 to \$4.89, with an average value of \$4.04 (Table 2.2). If we assume that a bank would place a five-day hold on the cheque (one respondent reported that US cheques were subject to a 21-day hold at their bank), then, by cashing a Canadian cheque immediately, the cheque-cashing firm is providing a very short-term, five-day loan. Using this formulation, annualized interest rates range from 104% to 259%.

The average cost to cash a \$100 cheque at a Winnipeg cheque-cashing firm is just over \$4. This is more than the average monthly cost for a basic account at a credit union or bank, which averages \$3.67 per month. With this basic account, the client can engage in approximately 12 transactions including cheques, automatic teller machine (ATM), and teller transactions. Per-item transaction costs range from \$0.50 to \$1.00, significantly lower than the \$4.00 paid at the cheque-cashing firm. The average cost to cash twelve \$100 cheques at a cheque-cashing firm, based on our sample, is \$48.48. This is \$44.81 more than what a bank client would pay. Cashing even two cheques of \$100 per month at a cheque-cashing firm will cost over \$8. This financial service charge represents a significant sum for a low-income person. In fact, it represents 3.3% of the provincial Employment and Income Assistance (EIA, commonly called social assistance) for a single person without a disability.

The number of payday loan firms and outlets has experienced the most rapid growth in the city in the last three years. As with cheque-cashing, personal identification is required for a person to be eligible for a payday loan. In addition, several other documents are sometimes required, including evidence of employ-

ment (e.g., pay stubs), evidence of permanent residence (e.g., utility bills), and evidence of a bank account (e.g., bank statements). This demonstrates that payday loans, unlike pawnshop loans or rent-to-own loans, target employed persons. This has been documented by a study recently undertaken by the Public Interest Advocacy Committee (PIAC) (2002). Their nationwide survey found that “the average income of the [payday loan] customers is roughly in line with the Canadian average household income. Specific vulnerable groups are also not heavily represented” (p. 36).

We found that payday loans were generally made for a two-week period in amounts of \$100 to \$300, the loan amount being limited to a proportion of the client’s anticipated paycheque. Fees for payday loans generally include an interest charge plus various transaction charges such as a processing fee and cheque-cashing fee. Fees and annualized interest rates vary across firms and loan amounts. Fees for a \$100 two-week loan vary from \$18 to \$38, with an average fee of \$26. Fees for a \$300 loan vary more widely across firms, from \$30 to \$76, with an average fee of \$63. Annualized interest rates vary as well. For a \$200 loan they range from 260% to 650%, with an average rate of 551% (Table 2.2).

Payday loan proponents claim that annualized interest rates are not a fair reflection of the cost of the service. They argue that because the loan is of short duration, costly to administer, and relatively risky, a better indicator of the cost to the consumer is the lump-sum fee. That payday loan firms are growing in numbers suggests that consumers are satisfied with the fee. However, mainstream banks also offer services that can involve short-term loans including credit cards, overdraft protection, and lines of credit, with interest charges usually not higher than 25% for these services. The annualized

interest rate for a payday loan is 55 to 68 times higher than for a credit card transaction.

Given the considerable variation in fees and associated annualized interest rates across firms, consumers would be wise to shop around. This would be facilitated by regulations that compel businesses to follow a common fee formulation, perhaps an annualized interest rate, and be required to clearly post this. In the businesses we visited in our outlet follow-up to the key informant interviews, we found that fees were not clearly posted and they did not use an annualized interest rate formulation. In some cases, employees were willing to write out for us the cost of various loan amounts. This is a more critical issue for payday loans than other fringe financial services because there are more fees and they are more complicated, often involving a daily/weekly interest charge plus two or more additional fees (e.g., broker fees, membership fees, cheque-cashing fee, item fee). Using a common formula to price these loans would help consumers judge among different products and particularly among different firms.

## **2.5 Rent-to-Own Services and Firms**

The rent-to-own service is a way for a customer to immediately obtain an item through a rental agreement. If the customer completes the contracted payments, they then own the item. Some businesses in Winnipeg have been offering a rent-to-own option for obtaining furniture and appliances for many years. According to the telephone directory, four businesses in Winnipeg offered that service in 1982. The numbers increased to between eight and nine through the 1980s and early 1990s, dropping back down to five in the mid-1990s, then rising to between six and eight in the late 1990s and early

2000s. These firms traditionally were general furniture and appliance retailers, who appear to have stopped offering the rent-to-own option in the mid-1990s. Then a new type of business, more exclusively focussed on rent-to-own services, was established in Winnipeg in the early to mid-1990s. At least two of the current six rent-to-own businesses in Winnipeg have locations in other cities.

In 1982, one rent-to-own service was established in the North End. Today, there are three rent-to-own businesses there, all almost exclusively focussed on rent-to-own services.

We interviewed two rent-to-own firm representatives. One respondent indicated that 60% of their clients were from Winnipeg and 42% were from the neighbourhood. The respondents claimed that 80% of their clients were Aboriginal, some of whom are from First Nations' communities outside Winnipeg. The respondents stated that 60% of their customers were female, and 85% received Employment and Income Assistance.

The key informants claimed that rent-to-own contracts ranged from 3 to 24 months. According to one respondent, the value of the loan imbedded in the rent-to-own contract ranged from \$1500 to \$3000. Respondents claimed that most of their clients intend to complete the rent-to-own contract in order to purchase the merchandise. In other words, the rent-to-own service is used primarily to obtain credit to purchase an item, as opposed to a rental service. The two respondents claimed that, on average, two-thirds of their clients complete the contract and keep the merchandise. Both firms had a buy-out option that allowed clients to complete the contract at an early date by paying some portion of the remaining balance.

One respondent was unwilling to disclose to us the fees and interest charges

associated with the contract. This respondent explained that once the customer had indicated the monthly fee and down payment she/he could afford to pay, the firm would determine the number of months needed to complete the contract and an agreement would be written. One firm charged an interest rate of 10% per month, or an annualized rate of 120%. Another firm revealed a hypothetical rent-to-own agreement that involved fees and an interest rate amounting to an annualized interest rate of 489%. The average annualized interest rate for these two rent-to-own contracts is 305% (Table 2.2).

## 2.6 Tax Refund Advance Service

A final type of fringe financial service considered here is the advance provided by some income-tax preparation companies. If there is a tax refund, these firms will give the client the option to receive an advance on the refund, for a fee. In a sense the client is receiving a loan from the firm, generally for two weeks (according to respondents from these businesses), the time it would take for the claim to be processed by Revenue Canada and the refund to be mailed back to the client.

At least two tax preparation firms, with several outlets in Winnipeg, offer seasonal tax-refund advance services. These two firms have a total of 37 branches (Winnipeg telephone directory). Of these, three are located in the North End, although on the periphery at Main and McPhillips streets. These firms calculate fees for the advance as follows: 15% of the first \$300 of the refund and 5% on any remaining refund. Assuming that relying on the postal system would mean the refund would arrive two weeks later, the tax refund advance amounts to a two-week loan. Using annualized interest rate calculation, this implies a rate of 286% (Table 2.2).

## 2.7 Other Fringe Financial Services

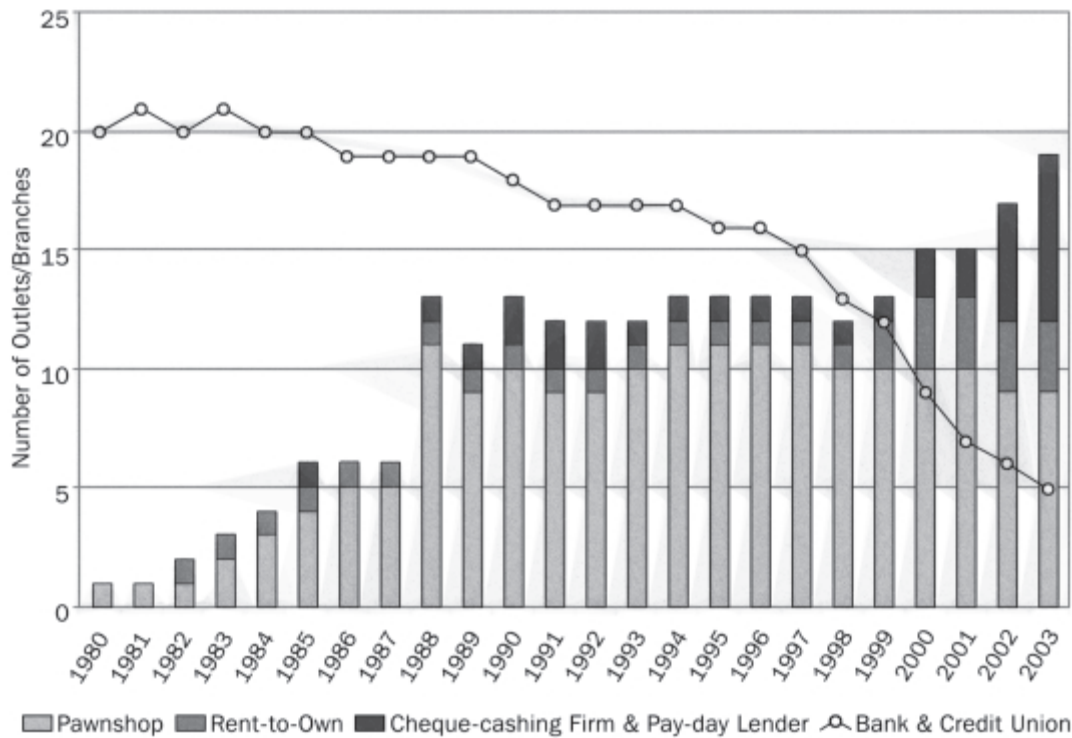
Other fringe financial services include “white label” ATMs, which are ATMs not owned and operated by banks or credit unions. These ATMs can only be used for cash withdrawals from one’s bank account. In addition to a bank transaction fee, the “white label” ATM charges a service fee. This fee is often approximately \$1.50, but one respondent indicated that the maximum fee allowed is currently \$4.00 per transaction and may be increased in the near future to \$6.00 per transaction.

## 2.8 Fringe Financial Services in Winnipeg’s North End

Fringe financial service firms are a growing phenomenon in Winnipeg’s North End. From one pawnshop in 1980, by 2002 there were at least 19 fringe financial service outlets (excluding white label ATMs and tax-refund advancers) as follows: nine pawnshops, two cheque-cashing firms, four payday lenders, and three rent-to-own outlets. While pawnshops were established through the 1980s, the newer fringe financial service providers (cheque-cashing firms and payday lenders) have grown in the early 2000s.

As fringe banks have increased their numbers in the North End, mainstream bank branches have declined. In 1980, there were 20 mainstream bank branches in the North End. The number dropped to 15 by 1997 and then plummeted to only five in 2003. There have been nine closures in the area in the last six years. During the course of this study, a mainstream bank announced its plan to shut another branch in the North End in August, making it the tenth in seven years. When this branch is closed, only three mainstream bank branches and two credit union branches will remain in the North End. At present

**Figure 3.1 Number of Selected Fringe Financial Services and Mainstream Banks/Credit Union Branches in Winnipeg's North End, 1980-2003**



Source: Winnipeg Telephone Directories and Outlet Follow-up

Data on numbers of payday loan and cheque-cashing outlets are approximations. During the period of data collections, the numbers varied considerably with new ones opening up and some older ones closing down.

Payday loan and cheque-cashing firms are the sum of the number of payday loan outlets plus the number of Money Mart outlets. In 2003 there is only one cheque-cashing outlet that does not offer payday loans.

there are six automatic bank teller machines and 13 white-label machines.

In terms of the geography of banking in the North End, the majority of the mainstream and fringe banks are located on Main and McPhillips streets and Selkirk Avenue. Main and McPhillips streets are major transportation corridors between the downtown and the suburbs. McPhillips (at Dufferin Street) is also the location of a major government-run casino. Selkirk Avenue, once a retail and business centre for the North End, has experienced significant decline so that today much of the commercial space is va-

cant. There are presently three pawnshops and one cheque-cashing /payday loan firm and one rent-to-own firm (that apparently offers cheque-cashing) there. Selkirk Avenue has been particularly negatively affected by mainstream bank closures, given the closure of two branches at Selkirk and Salter, and two other branches down McGregor Street. Another three branches have been closed on Main Street and two along McPhillips Street.

## 2.9 Discussion

Winnipeg's North End, particularly in the south, is a relatively disadvantaged area.

This area has lower incomes, higher rates of unemployment, and higher levels of dependence on social assistance than in Winnipeg on average. North Enders are also less mobile, as shown by their greater reliance on public transportation and less reliance on personal automobiles.

In the last 20 years, the North End has witnessed the decline in the number of mainstream bank branches and the rise in the number of fringe bank outlets. Fringe financial services are on the increase in Winnipeg and the North End. While pawnshops have been around for many years in the city, available statistics indicate that the first licensed pawnshop was established in the North End in 1980. Firms dedicated to cheque-cashing are a newer phenomenon, although their growth has not been as dramatic as that of the payday loan firms, which have only entered the Winnipeg and North End markets in the last couple of years. Although the rent-to-own service has been around Winnipeg for many years, the rent-to-own firm focussed almost exclusively on rent-to-own contracts and customers is a new and growing phenomenon. Tax-refund advancers and white-label automatic teller machines are also fringe financial services significant to Winnipeg and the North End.

Fringe financial services are in demand in Winnipeg and the North End as demonstrated by their growth. These banks provide a service for their customers. However, this research has documented that these services are very expensive. For instance, if one considers simply the absolute fee for the service (e.g., \$4 to cash a \$100 cheque), the cost is very high in comparison to a typical client's income. Alternatively, if the service fees are converted into an annualized interest rate associated with a loan, they are also very high (e.g., 260% to 988% for a payday loan). Moreover, most of these services are available at

mainstream banks, through such mechanisms as holding a basic checking account and a credit card, for a fraction of the cost. Compounding the problem is the fact that low-income people in the North End are generally less mobile than their suburban neighbours, so they have fewer options when it comes to financial services. In some cases they might be "captive" to a neighbourhood fringe bank that can take advantage of their situation.

Other than one or two anecdotal pieces of evidence, we have not found hard data to support the view that fringe bankers are earning above-normal profits. The fact that the payday loan and, to a lesser extent, the rent-to-own firms are multiplying does suggest there is profit to be made in the industry. One key informant pawnbroker indicated that his business had earned a handsome profit last year. The high growth rates in the number of cheque-cashing and payday lending outlets may reflect above-normal profits that are encouraging new entrants. High fees also reflect expensive and risky services offered by fringe banks. Market forces demand that these services be offered at a higher cost. The problem is that the very people who need a break on financial services, who need access to and understanding of mainstream financial services in order to improve their situation, are those who are being directed towards the fringe bankers. Fringe bankers have responded to this opportunity. However, the quality and cost of services that fringe bankers provide vary considerably, requiring *caveat emptor* (buyer beware).

The data in this section document the variation in fees associated with most fringe financial services. A payday loan or rent-to-own client can easily pay two or three times as much in fees from one firm to another. We also heard about other questionable practices, such as encouraging payday loan extensions and intimidat-

ing elderly payday loan clients to make payments. The system of micro, household-level finance that is segmenting so that low-income people are streamed away from mainstream banks and towards fringe banks is at the heart of the problem. This arguably impedes their capacity to move out of poverty by increas-

ing the costs they pay for basic financial services, and by creating or aggravating the disconnection between short-term (e.g., cheque-cashing, small loans) and long-term (large loans, savings) financial services. Fringe banks provide only the former type of services.

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## Client Motivations & Experiences with Fringe Financial Services

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One of our goals was to determine the motivations and experiences of fringe bank clients. We undertook a qualitative survey of 41 fringe bank clients in the North End to understand the growth of fringe bank services. We asked respondents to describe the informal, fringe, and mainstream financial services they have used or do use, and to comment on the value of fringe financial services.

### 3.1 Income: The Common Denominator

The use of fringe financial institutions stemmed from a situation of economic need, either in terms of acquiring a loan or expediency in cashing a cheque. It was of no surprise that low income was a common characteristic among the respondents. Although those within the low-income category indicated a variety of income sources, receiving Employment and Income Assistance was a substantial contributor. Of the respondents who were employed, part-time or casual employment was more common than stable, full-time employment. The primary income level cited by those receiving EIA was under \$10,000 per year, while for those who were employed, this increased to \$10,000 to \$20,000 per year. Some respondents had obtained a post-secondary education, which translated into slightly higher income. However, the repayment of student loans for these individuals contributed to their financial restrictions at the time of the survey.

The main cause cited for using a fringe bank was the inability to maintain a bank account or to be approved for credit. Respondents consistently demonstrated the link between being impoverished and be-

ing unable to maintain a bank account, as this comment illustrates:

*I had an account at [X Bank] but I closed it because I didn't have any money at the time. I was being charged \$9 per month even when there was no money in the account.*

This respondent had to close her bank account because of unaffordable service fees. This lack of surplus funds and/or credit contributes to a reliance on pawnshops when small loans are needed for general living or unforeseen expenses, and when financial support from friends and family was unavailable.

#### 3.1.1 Income and Informal Networks of Borrowing

In looking to larger social systems that facilitate the conditions leading to the trap of fringe banking, traditional forms of assistance are often limited in their scope by modern institutions. For instance, traditional informal supports between family members or community members have been hindered through restrictive EIA policies and the lack of a living wage offered in minimum-wage jobs. Several respondents said their relatives could not lend them much because they did not have enough savings themselves. One respondent said she would like to lend more to her family, but had no savings from her welfare cheque. Many respondents indicated they turned to friends and family for financial support before using fringe banking. These informal lending systems provide the basic function of financial support for respondents, but they are limited. As discussed previously, EIA regulations restrict the ability of people to save money, part of which could be used

to support informal lending to family and friends. Thus, informal borrowing networks are stifled in disadvantaged communities because many residents are unable to save the required funds.

### 3.1.2 Single Parents

Single-parent status was common for the respondents, in particular for female respondents. Several single mothers in our sample said they had quit their job or were considering quitting due to the unavailability of affordable child care. For these single mothers, EIA became a common source of income. Often, a single mother was supporting three or four children on less than \$10,000 per year. Thus, single parenthood contributed to a high level of poverty among female respondents. The feminization of poverty is apparent in the lack of resources available to the single mothers in our sample, including lack of available child care, and insufficient funds from EIA to afford daily living expenses for the month. This social disadvantage, in turn, restricted the financial options available to these women. The necessity of using fringe banks stems from the need for extra funds each month, the lack of transportation to get to the bank branch, the restricted use of banking services because of EIA regulations, and the inability to pay the fees associated with regular bank accounts.

### 3.1.3 Location of Mainstream Financial Services

Although low income was the common denominator in fringe bank use, location of banks was a frequently expressed and major concern for respondents. Several respondents who had been using banks in the past were now unable to do so because of the lack of banks in the North End. The low levels of income meant that very few people owned cars, a situation that restricted access to banks to cash cheques

when money was needed. For example, a respondent mentioned that their branch had moved twice and that it now took 45 minutes on the bus each way to access their account in person. Respondents often experienced difficulty in getting to a bank that was not within walking distance, as this comment illustrates:

*It is nearly impossible to bundle up my four small children in order to walk five or six blocks to the bank to cash a cheque, let alone travelling out of the North End altogether.*

Those without a bank account often admitted they would consider opening an account only if the bank was within a few blocks of their home. Many respondents cannot afford the transportation cost to reach mainstream branch locations.

### 3.1.4 Limitations to Cashing Cheques at Mainstream Banks

In terms of desired financial services, cheque-cashing was cited as a priority. Cashing cheques at a mainstream bank is preferred because this service is offered free of charge, or included in the general service fees. When asked if they were satisfied with the cheque-cashing services provided in the neighbourhood, one respondent answered:

*Well, sometimes I am dissatisfied because [Cheque-Cashing Firm] charges too much, especially when it is a smaller cheque. \$167 goes down to \$157. That \$10 dollars is a lot. I guess I am only satisfied that there is a service available for me to use. I am not really satisfied with fringe banking.*

Regardless of the savings associated with cashing cheques at mainstream banks, respondents still used cheque-cashing outlets fairly regularly, because of the convenience of hours, location, and the expediency in receiving the cash. The operating



hours of cheque-cashing outlets were a significant factor. Banks are typically closed during evenings and weekends, which makes fringe banking the only option for people who need money after normal banking hours. Employed respondents commonly indicated that the location and hours of banks are problematic, as they worked during banking hours. Bank hours were also of concern for respondents who were part-time or casually employed, as this type of employment often means less regular hours in which organizational functions are hard to manage. This, combined with the low wages received by respondents, resulted in a tight stretch of time and funds that made waiting for an opportunity to access a bank impractical. Thus, these respondents felt that cheque-cashing institutions—with their long hours and numerous locations—were their best option:

*When I cashed my damage deposit cheque it cost me \$7.50 to cash a \$135 cheque. I could have taken it to my branch the next day but I couldn't wait—I needed the money to move.*

The five-day hold that mainstream banks commonly place on cheques is impractical for respondents who need the money quickly. As a result of living in poverty, individuals often have no choice but to pay more to cash their cheque.

### **3.1.5 Overdraft/Credit Cards and Loans**

A variety of factors restricted respondents' access to overdraft services, credit cards, and loans through mainstream banks. Usually banks refused to provide these services to respondents with low incomes because they were seen as a financial risk. Respondents who have claimed bankruptcy in the past were also denied overdraft, credit card, and loan privileges. Lack of access to short-

term loans was often why they accessed fringe bank credit, as the following statement illustrates:

*I am borderline diabetic and sometimes need money for fresh fruit. I have also pawned things for emergencies. In 1993 I needed money for a funeral. When you are stranded and you only have one option, you take it. It was my last resort. I lost some things that time—there were too many items to redeem.*

As a result of not being able to access mainstream banking services, many respondents used pawnshops loans to cover unforeseen expenses or emergencies, such as medicines, school supplies for their children, birthday or Christmas gifts, child-care expenses, and trips to visit relatives who were ill.

### **3.1.6 Availability of Mainstream Banking**

Respondents whose employment status changed, resulting in a higher income, had a reduced need for fringe financial institutions. This demonstrates that income is a determinant in fringe bank use. This varied across different types of fringe banking businesses, affecting the decreased use of pawnshops most significantly.

*I don't use pawnshops anymore because now I'm employed. My \$20,000 annual income has reduced my need for money at the end of the week. I use cheque-cashing outlets now because my job hours are late and they're the only ones open.*

In this case, the increase in income helped respondents manage financially without the small loans previously obtained through pawning personal items.

While there is clearly a correlation between low income and pawnshop use, the

correlation was less clear with cheque-cashing. Although some of the more financially secure respondents reduced their use of cheque-cashing services and opened a bank account, most of the respondents continued to use these services.

Even when higher incomes allowed respondents to maintain a bank account, they continued to use these services because of the convenience of the location and hours of operation. Even though these respondents had a reduced need for small loans due to their rising incomes, residency in the North End still put them at a disadvantage because of the scarcity of local mainstream banks. In fact, the relative increase in income was rarely enough to be able to pay for transportation to banks outside the North End. Thus, the low-income bracket of the neighbourhood continued to affect the choices for financial services, regardless of individual financial gains.

Although most respondents understood that fringe financial services are more expensive than mainstream banks, a surprising aspect of our findings was that many respondents expressed gratitude that fringe banks exist in the North End to provide a service otherwise unavailable to them. Indeed, these financial service outlets, such as cheque-cashing firms and rent-to-owns, are easy to access and offer services that are suited to the needs of North End residents. Pawnshops provide clients with quick access to cash to meet emergency needs when other sources (e.g., bank, family or friends) are not available. In essence, many of the individuals interviewed use fringe financial services despite the costs because it is the only reasonable choice. Overall, respondents said fringe banking was beneficial in providing much-needed services and, at the same time, was taking advantage of low-income people:

*Poverty is a booming business. Someone is making a lot of money off people who don't have much to begin with.*

Several of the fringe bank clients recognized that the services were, in some cases, deepening their debt load. In many cases clients did not know exactly how the fringe bank fee compares to mainstream bank services, but they did understand that accessing fringe financial services has a higher cost.

### 3.2 Discrimination

The issue of discrimination was not a question we intended to study, but this subject was frequently brought to our attention throughout the surveys. Discrimination is not often studied in relation to financial services, perhaps due to the presumed impersonal and objective nature of bank policies, including credit scoring. However, in a study concerning access to credit, Ramsay (2000) identifies discrimination as one of the circumstances that render consumers vulnerable to using fringe banking systems. He cites the Kearney case, a recent decision of an Ontario Human Rights tribunal that declared that the use of 30% rent-to-income ratios as a screening device by landlords contravened the Ontario Human Rights Code. The decision was based on the acknowledgement that this criterion had a disproportionate adverse impact on groups protected under the code, such as single female parents or those on government assistance (p.35).

This case has significance for financial institutions that use credit-scoring systems as screening devices for granting credit. Ramsay argues that the apparently neutral and objective criteria used by banks to legally discriminate among potential credit applicants may be used to justify discretionary decision-making based on stereotypes (p.35). Indeed,

myths about the poor or those on public assistance, such as that they are irresponsible in managing their money, affect public attitudes.

The issue may be raised that a similar set of discriminatory stereotypes has been in effect through the decision of several banks to leave the North End. Given that poverty intersects with a large Aboriginal population in the North End, the possibility of stereotypes affecting the policies of banks is two-fold. Spokespersons for financial institutions maintain that the regulations pertaining to opening accounts and receiving credit are based on objective market criteria, and that it would be contrary to the interests of their business to turn away credit-worthy consumers (Ramsay 2000, p. 35). Yet, in our study, we found evidence that suggests it is not as straightforward as this.

### 3.2.1 Employment and Income Assistance

The Canadian Human Rights Commission has raised the possibility of adding “social position” to the enumerated grounds in the Federal Human Rights code (Ramsay 2000, p. 35), since poverty is increasingly seen as an individual characteristic (like being overweight) that causes individuals to be judged on the grounds of prejudice rather than personal merit. However, we argue that poverty is more simply a potential source of differential treatment, resulting in policies based on universal criteria. Typically, respondents on EIA did have a bank account, but generally used it only for depositing EIA cheques. Most of these respondents believed that being a recipient of EIA prevented them from having a savings account.

*I once bought a Canada Savings Bond for my grandson. If welfare found out they would cut me off. Welfare says you*

*can't have a savings account. I want to be able to save at a bank, but welfare wants total control of your life.*

A frequently expressed concern was that any saved money would subsequently be deducted from the next EIA payment, that if the respondent was caught saving money, they could be denied any further social assistance services by EIA. Because of this belief, those on EIA used only controlled accounts restricted to the deposit and withdrawal of EIA cheques. Thus, although those receiving EIA were not denied access to a bank account, respondents felt discriminated against in their ability to save through a bank. They believed that receiving EIA promoted a situation in which their original financial disadvantage was deepened or forcefully maintained.

It should also be noted that respondents expressed concern that they could not let their children open a bank account because any savings their children incurred would be deducted from their parents' next EIA cheque:

*With social services, they don't allow you to have a savings account—even for your children. I have an 18-year-old who has nothing saved. I would have put \$45.00 away for her each month if I were allowed. If I drop dead, I leave nothing for my kids.*

The respondents commonly expressed the view that they are not allowed to have any type of saving for themselves or for their children. This reinforced the feeling that they were discriminated against by both the government and the mainstream banks. According to respondents, once you are poor, your children are systemically disadvantaged.

There are provisions in the EIA policies that allow for limited savings, but these policies are ineffectively communi-

cated to recipients. According to inquiries we made afterward, it seems that EIA advisors do not inform beneficiaries about these policies, and certainly do not encourage beneficiaries to take advantage of that opportunity to save. The Employment and Income Assistance Act states that recipients of standard EIA can acquire liquid assets of \$400, plus an additional \$400 for each dependant, up to a family maximum of \$2000. These savings, however, may be acquired only once the family is receiving EIA. To be initially eligible, the applicant must have first exhausted any liquid assets. This original obligation likely influenced people's perception of the rules pertaining to savings.

The ability of recipients to save money once on EIA is also greatly hindered by the difficulty in making ends meet on the EIA monthly allowances. As a result, lack of savings has forced several of the respondents to first use a fringe bank loan when they were facing an emergency. This initial access to fringe banking was, according to them, the entry to a spiral of dependency. Allowing initial savings to be available to individuals eligible for EIA would help alleviate some of these problems.

In addition to the financial benefits that children of EIA recipients miss due to their parent's limited income, the negative perceptions surrounding savings and EIA policy prevent parents from teaching their children basic saving habits that could help these children to gain economic self-sufficiency. In fact, it can be argued that the policies of the EIA program regarding savings are placing recipients' children at a disadvantage by making saving, and learning how to save, a privilege limited to self-sufficient families.

### 3.2.2 Respect and Courtesy

Respondents also discussed the issue of

respect and courtesy in using mainstream banks, although we did not have specific questions about this topic. Respondents raised several concerns in this regard with the services offered through banks. They commented on feeling alienation and discrimination; they often expressed feeling mistreated and disregarded by the bank tellers because they received social assistance. Respondents noted with distaste that they stopped using their bank because tellers would insist on personal identification even though they had a debit card. There are various reports of this kind of dissatisfaction with being treated rudely and with disrespect.

*I tried to open a bank account but I got attitude—they wouldn't open an account for me. I had to go to [Cheque-Cashing Firm] to cash my cheque. I tried at [Bank] also, but they said they would do a credit check and then I was refused.*

Comments about feelings of mistreatment were usually directed at banks, but there were notable accounts of this feeling associated also with the local credit union. Although the most often mentioned credit union of the Winnipeg North End has no ethnic criteria for membership, it appears that Aboriginal respondents do not often frequent this business as most of them thought memberships were restricted to Eastern Europeans. This might be the result of past (or even actual) practices of discrimination, not necessarily from that specific institution, but from non-Aboriginal ethnic organizations in Winnipeg. The importance of customer service was also a concern; a number of respondents listed "friendliness" as a trait they would like to see in new services offered in the North End, even though this was not a question we specifically asked.

*I tried to open an account at the near by credit union. I left without opening an account because the teller was rude.*

*Distance is not the only factor. Being treated with respect is the most important thing.*

It is important to note that the convenience of a bank's location was not enough to ensure patronage; respondents also wanted to be treated kindly and with respect. On the other hand, respondents did not complain about discrimination at fringe banking facilities. In fact, they consistently indicated being well treated in these places.

These experiences reflect disrespect and discrimination on behalf of bank tellers. Regardless of their ability to maintain a bank account or be worthy of credit, our respondents expressed reports of rude treatment, overly strict identification requirements, and refusal of services based on visual cues such as race, dress, and the fact that respondents were receiving EIA. This was especially true for respondents who tried to maintain an account with their bank after their branch in the North End closed. Although respondents' files were transferred and their affiliation had no reason to be questioned or reviewed, most of the respondents in that situation felt discouraged to maintain business in the new branch, where the regular clientele was better off financially than in their previous branch.

### **3.2.3 Identification**

Associated with the limitation poverty placed on mainstream banking is the fact that a lack of personal identification prohibited several respondents from opening a bank account. Due to lost, stolen, or unavailable identification (a common situation facing people living in low-income neighbourhoods), banks would neither open a bank account nor cash a cheque. The following respondent noted the limited forms of identification that are accepted as valid:

*I tried to use my photo Métis card. [X Bank] told me they don't consider it a valid ID. I was upset, this is who I am, how can they tell me it's not acceptable.*

The most recognized and widely accepted form of identification was a driver's licence, which can be costly to obtain and inappropriate for those who do not drive. Although impermanent residence and/or lack of a telephone may also contribute to the inability to replace identification, the cost incurred in maintaining identification (transportation to the driver licensing office, annual cost of the licence) was the primary obstacle. Whatever the reason, respondents felt discriminated against by their inability to meet bank standards for identification. This situation was difficult for the respondents to accept, as their inability to have identification was only a result of their general economic condition and not the consequence of being a non-credible citizen.

As exemplified in the quote above, being told they had inadequate identification was often perceived as a rejection of their ethnic identity. Not accepting a Métis card as a valid proof of identity is indeed a patent form of discrimination, since the status of Métis is recognized in the Constitutional Act. Furthermore, because the processes and genealogical evidence to obtain a Métis card are strictly established, a Métis card is no less a proof of identity than a Status Indian card. Refusing to accept it is evidence of the ongoing resistance in the Manitoba population toward Métis claims and attempts to be fully recognized as Aboriginal people.

### **3.2.4 Safety**

Although respondents routinely echoed concerns for their personal physical safety while using bank machines, they also understood that the fear of crime was one reason why mainstream banking facilities

were scarce in the North End. A common assumption was that banks had left the North End because of the threat of robbery:

*I want banks back. The area used to be beautiful. We need patrols here now; it is not safe to walk at night. If we had safety the banks might come back.*

In this regard, we can say that the individuals not only felt directly discriminated against because of personal characteristics, but also because their neighbourhood is deemed unsafe. We can only assume, though, that crime was not a major consideration in banks' decision to leave the area, as the comparable growth in fringe banking has not been hampered. However, the respondents' perception might be explained by the way media focusses attention on this neighbourhood when a crime has happened. As a result, the respondents might be inclined to believe that the rest of the population sees their community as unsafe. In some respects, respondents who associate insecurity and bank departure might be trying to rationalize what they experienced, preferring to believe that the banks' decisions were based on economic realities rather than on prejudice against the North End.

### 3.2.5 Control and Anonymity

Compared to the impersonal and undemanding transactions of fringe banking, which require minimum identification, personal information, and commitment, banks are sometimes seen as a "big brother" institution, an extension of state control. As such, banks were sometimes viewed by our respondents through a suspicious and distrustful lens.

*I used to have an account with [Bank] but they started taking money from my account. Once I found \$200 missing from my account, another time \$60 was*

*missing. I don't think they were service fees.*

It is possible that some of the reasons for this perception of distrust were rooted directly in the banks' bureaucratic operations that required particular identification, a mandatory holding period for cheques, and a mandatory minimum account balance. For example, the lack of privacy in opening a bank account deterred some respondents who thought the banks had no right asking so many questions. "No questions asked" was also a common reason for pawning rather than borrowing from a bank. In this regard, bank policies can provoke the feeling of personal discrimination regardless of the particular actions of the teller. Typically, the respondents wanted to retain a sense of autonomy and personal control over financial activities that banks could not offer. Although alternative services tended to be more expensive, they allowed the patrons to retain direct control over the transaction.

Most fringe banks do not demand that patrons disclose personal information. Respondents' desire not to be questioned again indirectly attests to a global atmosphere of discrimination. They are so often questioned about their identity, and not always for legitimate reasons, that even when the questioning is legitimate, they are suspicious. As a result, they are ready to pay a higher price for a service that will treat them as if they were regular and trusted citizens.

### 3.3 The Spiral Effect of Fringe Banking

A relationship exists between the social conditions that result in fringe banking and the social conditions exacerbated through these services. For the respondents, the convenience and availability of fringe banking could quickly encourage

a dependency on these services. The following excerpt from a testimony summarizes what most respondents said:

*At the time when I needed money, it was good that there was a way to get it. But I look at it now and they (fringe banks) charge way too much. It is ridiculous to pay \$24.00 out of a cheque. You never get out of the hole, especially if you are on social assistance, you just can't get out of the hole.*

By catering to customers within a low-income bracket, the high-interest demands of fringe banking created a cycle of debt that ensured the continued use of pawnshops for small loans, cheque-cashing outlets for immediate cash, and rent-to-own services for purchases. Respondents viewed fringe banking facilities as providing services unavailable elsewhere, but the attraction and necessity of fringe services manifest as a downward spiral. For individuals who had become caught in this system and had low-paying employ-

ment, received EIA, or struggled with addictions, it became very difficult to accumulate surplus cash or even a sufficient monthly income to pay off the interest on previously pawned items, pay for cheque-cashing and bill-payment fees, and other high interest services, while still being able to cover the everyday costs of living. Yet the further into this spiral they were, the harder it was to get out of debt, save money, become eligible for legitimate loans, or take measures that may have helped encourage upward mobility such as training and education.

This spiral, though, cannot be attributed entirely to the fringe banking facilities, as these services fill a void previously established through mainstream banking practices. Excluded from the mainstream opportunities of saving accounts, credit, loans, cheque-cashing, and more, North End residents are marginalized as a result of their socio-economic status and geographic location.

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## Questions of Legitimacy and Community Benefits of Fringe Banks

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One of the goals of the research was to confirm or refute the perception that fringe banks overcharge low-income customers. Therefore, one component of the research involved interviewing specialists from a variety of groups concerned with the fringe bank industry, to gain an overall understanding of the fringe financial service phenomenon by exploring different views expressed, and issues identified, by key groups with regard to fringe banks. Respondents were selected who had specialized knowledge about fringe financial services or the community needs of the North End.

Twenty-seven interviews were conducted with key informants from the following categories: fringe financial services, banks and credit unions, community development practitioners, key government departments, and relevant politicians. This section summarizes the main issues raised in the interviews and identifies different perspectives held by these groups related to the issue of overcharging by fringe financial services.

### 4.1 Fringe Financial Service Firms

One of the most important informant groups for this part of the study is the fringe financial sector itself. We wanted to interview as many people as possible from the industry to develop a better understanding of the firms' motivations and experiences. However, we had only partial success: some firms were unwilling to allow interviews. Three pawnbrokers and two rent-to-own managers agreed to participate in interviews, but other pawnbrokers, rent-to-own managers, and nine cheque-cashing/payday loan firms refused participation. One cheque-cashing/payday loan firm agreed to participate by

sending a written reply to our questions after consultation with their lawyer.

In addition to providing data on services and fees, fringe bankers were asked to comment on the legitimacy of their services and on their perceptions of their clients' motivations. Regarding legitimacy, bankers were asked to comment on whether they overcharge their clients, whether they follow fair business practices, and whether they are associated with illegal activities. All the respondents agreed that their businesses are legitimate and that they offer important services to their clients. Pawnbrokers, rent-to-own respondents, and the cheque-cashing/payday loan firm claimed that their services contribute to the community. They argued that they were facing high costs and risks in order to provide unique services. One pawnbroker commented that it is mainstream banking, accounting, and legal services that are illegitimate because of the fees they charge and the profits they generate. This pawnbroker argued that the profits generated in pawnbroking are not greater than in other industries.

In some cases, fringe bankers made claims regarding their services that seemed exaggerated. For instance, some bankers claimed to offer services intended to improve the client's credit rating but the programs they described seemed to have doubtful benefits for the client.

Pawnbrokers and rent-to-own respondents claimed their services are fair since they provide access to credit for people who cannot obtain it otherwise. A rent-to-own respondent reported that their business provides a means for low-income people to purchase items such as a television or sofa. The respondents argued that their high service fees were



fair, since they had higher transaction costs due to the many small, high-risk loans they processed.

From the interviews with pawnbrokers and other key informants, we learned that pawnshops are regulated against trading in stolen goods through the municipal government. Potential pawnbrokers are required to obtain a zoning variance for their proposed premises and to obtain a pawnshop license from the city. The license must be renewed annually and all pawning transactions are monitored by police pawnshop patrol. Because of these practices, pawnbrokers claim that they are legitimate and do not deal in stolen property. However, some respondents, including one pawnbroker, claimed they were aware of a stolen goods trade in some pawnshop “hot rooms.”

The cheque-cashing/payday loan respondent objected to being grouped with pawnshops and rent-to-owns within the fringe financial service category; the firm claimed to serve clients with higher incomes who have access to bank accounts and credit cards. The respondent stated that the firm provides financial services to working people in a fair and convenient manner. For instance, they require the loan to be repaid at the deadline with no option for the loan to be extended or “rolled over.” This practice decreases the likelihood of large debt loads due to accumulating interest.

Another major issue we raised dealt with the fringe bankers’ perception of their clients. We asked respondents to describe the general income level of their clients and explain why they thought their clients used fringe financial services. Several respondents commented that many of their clients have low incomes. They acknowledged that their services, while fairly priced, are expensive for these people. When asked to comment on clients’ motivations for using expensive services,

some bankers responded that their clients lacked the self-discipline to save. This lack of self-discipline, they believed, was the result of various pressures ranging from gambling and substance abuse to consumerism (a preoccupation with buying consumer goods). Therefore, it seems that fringe bankers see gambling, substance abuse, and consumerism as reasons why people access their services. This point highlights a tension or contradiction in the claims they made. On the one hand, they claim to provide a legitimate service that benefits their clients; yet, on the other hand, they claim the client’s need for the service is the result of social problems such as gambling, substance abuse, and consumerism.

#### **4.2 Mainstream Financial Service Firms: Credit Unions and Banks**

The relationship between mainstream financial institutions—i.e., banks and credit unions—and the fringe banks is complex. This was shown in the interviews we had with informants from the mainstream banking sector. Credit unions, and, to a lesser extent banks, claim they are populist institutions providing financial services for the common person. However, both credit unions and banks face stiff market competition. In addition to this, banks must respond to shareholder demands for high profits. These pressures require mainstream banks to take advantage of new technologies, globalizing markets, and changing consumer demand. Thus, contradictory pressures are placed on mainstream financial institutions. They claim to be for all Canadians, but they are also closing branches in inner cities and rural locations.

We interviewed two informants from Manitoba credit unions about the issue of fringe financial services. A third credit union with a branch in the North End declined to be interviewed. The credit union respondents were quite aware of is-

sues of financial services for low-income people and about the growth of fringe financial services. In fact, one credit union organization had undertaken an informal study of fringe banks that documented the high cost of fringe bank services. Credit union respondents did recognize the difficulty in offering financial services in low-income neighbourhoods. One respondent noted that financial services for low-income people are generally costly to provide, echoing a perspective expressed by some bank respondents.

We interviewed two mainstream bank representatives based in Winnipeg or Manitoba area. We also approached two other mainstream banks to be interviewed; however, one bank declined to be interviewed after internal processing and the other bank stopped the interview just as it was starting. Later, we received a one-page letter from both these institutions, responding to some of our questions. The mainstream bank interviews were broader in scope than credit union interviews. Some of the issues that were discussed included: amalgamation and closure of branches, changing market/profit expectations for banks, public relations, and the relationship between banks and fringe banks.

When respondents were asked to explain why bank branches have closed in the North End in the last 10 years, bank officials said branches were undergoing a process of amalgamation that would, in fact, improve the provision of financial services to their clientele. All respondents referred to the increased use of technology such as automatic teller machines and Internet banking as reasons for closing branches. Since consumers can access their financial services through these new technologies, there is less need for branch operations.

Respondents had mixed responses when asked if the lower average income

of North End residents was a factor in North End branch closures. Two respondents said that community income level was not a factor in closure; two others said directly or indirectly that it was a factor. Those who said it was a factor indicated that lower income clients tended to use less financial products and to require different types of services, which generates less profit for a branch, thereby possibly resulting in a branch closure. This comment suggests that it is not people who drive the bank services, but the consumer demand for bank products, itself driven by income.

When asked about the distribution implications of branch closures, respondents claimed that closures were equally distributed around the city. Respondents also claimed that low-income consumers could equally well use ATMs and the Internet to access their bank. When asked about the mobility of low-income consumers, one respondent denied that low-income people in the North End had less access to transportation than people in other areas of the city.

One respondent accented the important role that profits play in the bank's decisions about branch operations, commenting that the major banks face stiff pressures from their shareholders to generate acceptable levels of profit. This high expectation places added pressure on the bank to close marginally profitable branches. When asked if the bank might engage in financial service outreach in a low-income neighbourhood, one respondent claimed this was not feasible, given stakeholder expectations and financial constraints.

The banks also emphasized their desire to respond to consumer demand and maintain a positive public image. According to one respondent, the bank has a variety of stakeholders it must remain accountable to: shareholders, bank employ-

ees, bank clients, and the general public. Accordingly, the bank must carefully consider their interests in its decisions. When asked about the banks' contribution to the community, two of the four respondents referred to their banks' charitable donations, primarily for social welfare agencies.

A final issue we explored in these interviews dealt with the financial relationship between mainstream and fringe banks. One bank respondent described a clear relationship between the bank and "one or more" cheque-cashing firms, whereby the bank provides the fringe service with financing, cheque-clearing services, overdraft protection, and lines of credit. This means that although mainstream banks are closing inner-city branches, they continue to participate in the inner-city market through financing fringe banks. The consequence of this is that low-income neighbourhoods face a narrower and less beneficial range of financial services. Mainstream banks, on the other hand, are able to continue to generate profits from low-income neighbourhoods, but delegate financial service to fringe banks.

If, on the one hand, fringe bank growth is the result of branch closures, then this relationship suggests an unhealthy form of market segmentation on the basis of income level. Full-service mainstream banks are directed at middle- and upper-income neighbourhoods, while fringe banks, financed by mainstream banks, are operated in low-income neighbourhoods. Income inequality leads to financial market segmentation, which leads to further income inequality. On the other hand, if fringe bank growth is unrelated to bank branch closures, but due to market liberalization and innovation, then the mainstream-fringe relationship might not reinforce income inequality. Clearly, this question requires more attention by researchers and policy makers.

### **4.3 Community Leaders and Community Development Practitioners**

We spoke with 10 people we describe as community (economic) development practitioners or community leaders. We asked them about existing and potential financial service providers—mainstream banks and credit unions, fringe banks, and community alternatives—and the role of credit and savings in personal and community development.

In terms of North End residents' relationship to mainstream banks, respondents agreed that many low-income North End residents do not use mainstream banks and credit unions. However, they did not agree on why. Respondents cited a number of factors why residents might not access mainstream banks: the closure of branches; the availability of superior—albeit more expensive—services by fringe banks; the lack of picture identification needed to open a bank account; the lack of adequate transportation or Internet access; and the claim that low-income people operate largely outside the financial (credit and savings) economy. A particularly important tension in these responses relates to the assertion that low-income people in the North End traditionally have not used mainstream banks. Some respondents strongly argued that bank closures were the cause for low participation, while others claimed that even when the branches were open in the North End, few low-income residents used these services.

One community respondent reported that North End residents conduct their business with fringe banks because mainstream banks do not possess comparable convenience and level of respect for low-income clients. Considering the bus fare needed to get to the bank, plus the added convenience and respect found at some fringe banks, the economics and social

costs may weigh in favour of using the fringe bank. Some respondents believed that the lack of financial literacy made service fees difficult to understand for North End residents. Moreover, culture and language barriers for newcomers to the North End from First Nations' communities and other countries compound the problem.

Respondents were asked about the usefulness of fringe banks for North End residents. Several said that while fringe banks provide a service for people, these services can be destructive by charging high fees or drawing people into a destructive cycle of debt. Several respondents noted that the costs and risks associated with fringe banking are relatively higher than mainstream banking, and that these costs are passed on to the consumer. One respondent pointed out that fringe banks are the only financial service available for many North End residents. Without the local pawnshop, a family may need to go without basic necessities or resort to illicit means to obtain money.

Respondents expressed a variety of views about the viability of a community alternative to fringe banks. Some thought the success of the venture depended on the existence of super-normal profits in the fringe-banking sector. These respondents thought that in the absence of super-normal profits, a non-profit, community-based alternative could not survive. The logic of this argument is that the existence of super-normal profits would allow a non-profit agency to offer the services at a low cost, since it does not generate a profit itself. A related issue is whether a non-profit organization can develop a practice that includes "saying no" to potential clients' request for loans. In order for a non-profit to offer financial services such as payday loans, they would be required to refuse some loans. Respondents expressed concern that employees of a

community venture might be soft-hearted and extend risky loans, which would undermine the model's viability.

Finally, the respondents raised several interesting points related to the role of credit and savings in personal and community development. Some respondents reflected on the problem of excessive credit and its relationship with financing non-basic needs and building a debt problem. If the cycle of debt spirals out of control, the long-run result is growing poverty with fewer resources available to devote to basic needs. Respondents spoke about fringe credit as being associated with a feeling of hopelessness or an attitude of apathy. Other respondents reported a relationship between the use of fringe banking and consumerism. According to one respondent, consumerism pressures are acute for low-income people because their relative deprivation forces them to continuously deny themselves things that other members in society take for granted. Accordingly, in a society that emphasizes that one's value depends on one's material possessions, credit may be used to purchase goods in order to boost one's self-esteem.

#### **4.4 Government Officials**

We interviewed four key informants from federal, provincial, and municipal (police) governmental levels. The issues raised by these informants included fringe bank legislation, the criminal rate of interest, complaint-driven consumer protection and the monitoring and law enforcement of pawnshops for stolen goods.

Key provincial and federal respondents agreed that fringe financial services fall under provincial jurisdiction. The federal government has no direct jurisdiction in the area of fringe financial services except with regard to the criminal rate of interest. The Financial Consumer Agency of

Canada, a federal agency, does have the mandate to educate financial consumers about all types of financial products to help them make informed and beneficial decisions for themselves.

Although fringe banks are a provincial responsibility there is no specific legislation in Manitoba for fringe banks. Aspects of fringe bank operations relate to the Consumer Protection Act and the Business Practices Act. For instance, the Consumer Protection Act requires that fringe bankers disclose all fees associated with their service. A government informant added that recent case law has found that all fees associated with fringe bank loans constitute the interest charge for the loan, sometimes referred to as APR, annual percentage rate of interest.

A second issue raised in these interviews dealt with the criminal rate of interest. Section 347 of the Criminal Code of Canada says that it is offence to charge an annual interest rate in excess of 60%. Respondents indicated that it was inappropriate to apply the criminal rate of interest to universally regulate fringe banks. The universal application of section 347 would hurt consumers who are using fringe bank services in greater numbers and satisfied in paying fees well in excess of 60%. Universal application of section 347 would shut down one of the few sources of financial services some people have, forcing them to use the underground economy. If a consumer is dissatisfied with a fringe financial service, we were informed, the consumer could make a complaint to the Consumer's Bureau. If the consumer paid interest charges in excess of the criminal rate of interest the bureau would require the fringe bank to adjust the fees below 60%. Besides being in the consumers' interests, this patchy

legislation and enforcement is justified in that the responsible department has limited resources to monitor all fringe banks. Furthermore, it was noted that the Consumer's Bureau has received few complaints about fringe financial services. This suggests that clients are satisfied with fringe banks and, according to the respondent, this justifies the status quo of provincial government legislation and enforcement.

Respondents reported that there is an intergovernmental committee that is seeking to develop model provincial legislation for fringe banks. This committee has developed a model for legislation of fringe financial services for adoption by interested provincial governments.<sup>16</sup> The Manitoba government does not plan to introduce new legislation at present.

The final respondent in this group was from the Winnipeg police service. This respondent supported the claims already made by pawnbrokers regarding the high regulation of pawnshops. These regulatory measures are put in place to stop the buying and selling of stolen property, and not to regulate pawn fees.

#### 4.5 Winnipeg Politicians

We interviewed two politicians who are interested in the issues of financial services in the inner city. The issues they raised include: betrayal of the community by banks through branch closures; the relationship between bank branch closures and fringe bank growth; the lack of government action regarding bank closure and fringe banks; and the hope that credit unions and/or non-profit organizations would meet local needs.

Both respondents thought the community had suffered as a result of branch clo-

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16 Consumer Measures Committee. 1998., "Agreement for Harmonization of Cost of Credit Disclosure Laws in Canada: Drafting Template" [on-line]. Available: <http://strategis.ic.gc.ca> [Accessed 15 October 2002].

tures. One politician was concerned that branch closures have negatively affected elderly and low-income people. The replacement of some branches with automatic teller machines has not helped those people who want to do their banking in person. In fact, it has created a sense of loss for many seniors who saw the local branch as part of the community. Another respondent claimed that the growth of fringe banks in the North End is directly related to the closure of mainstream banks. The fringe banks have filled a vacuum created by the bank closures.

Both respondents thought the federal government has not effectively responded to the changes in financial services in the North End and other low-income communities. One respondent said the federal government should play a more active role in fostering fair financial services. Another respondent called for legislation that would ensure bank participation in low-income neighbourhoods, and a cap on interest rates charged by fringe banks. Both respondents looked to the credit union and non-profit sectors for solutions to the problem of expensive financial services for low-income people.

#### 4.6 Conclusion

Key informants we interviewed had mixed views regarding the legitimacy of fringe bankers. Many respondents saw fringe bankers as plugging a hole in the financial system. They thought that the more costly fringe financial services are justified since the mainstream financial system cannot meet the needs of low-income people. Others respondents said fringe bankers are illegitimate since they charge unfair fees, engage in unfair business practices, and/or are involved in the illegal economy. Examining the respondents' views in greater depth reveals interesting tensions:

- Some fringe bankers claim to offer a service, but argue that their clients are often misguided (due to gambling or substance abuse) in using the service. They claim legitimacy and then “blame the victim.”
- Mainstream bankers claim to be accessible for all Canadians, yet they close branches in the inner city and must know that low-income people are less mobile and less likely to own computers and have access to the Internet. That some mainstream banks finance and service fringe bankers suggests that mainstream banks are still benefiting from low-income clients, but less directly.
- Community development practitioners disagreed on whether it was branch closures or social and economic costs that led low-income people to use fringe banks. Regardless of the cause, the consequence is that low-income people face limited services with high fees, and community development practitioners are interested in addressing this need.
- The provincial government holds a contradictory position of, on the one hand, claiming the existing fringe bank legislation is adequate, and, on the other hand, using the criminal rate of interest as a standard to roll back interest charges for people who complain. Is it a criminal rate of interest or isn't it? At present it appears the government is letting the consumer be the judge. If that is the case, then the criminal code does not seem to be the appropriate location of legislation. The federal government, and in particular the Federal Consumer Agency of Canada, could also do a lot more to educate consumers about fringe financial services.

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## Community-Based Alternatives to Fringe Financial Services

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The absence of mainstream financial services and the growth of fringe financial services in some communities have prompted the development of alternative organizations and programs to meet some of or all the financial service needs of people in various communities. While some initiatives merely seek to offer the same services as fringe financial outlets at less usurious rates, other initiatives incorporate a more holistic set of financial services for low-income people. We interviewed representatives from these organizations about their programs to determine the basic mandate, services, fees, and operations of these programs.

### 6.1 Community-based Alternative Models to Fringe Banks

Many organizations and programs in Canada and the US seek to address low-income people's financial service needs from a community basis. To describe the diversity of these programs, this section highlights three of these: Cash and Save in Toronto; the Four Corners Savings Association in Vancouver; and the Desjardins *Caisses Populaire* micro-loan pilot project in Quebec.<sup>17</sup>

#### 6.1.1 Cash and Save (Toronto)

Cash and Save, a subsidiary of the Royal Bank of Canada, was established in Parkdale, Toronto, in 2002 in response to a community-identified service void. The conceptual roots for the initiative originated through community relationships established by a community banker. Cash and Save continues to consult with a Com-

munity Reference Group made up of various community representatives who act as the community "eyes and ears" for the branch. Services offered include bill payments, money orders, money transfers, and cheque-cashing (free for government issues and the greater of \$4.00 or 1.25% of the cheque value for other cheques). Service fees charged at Cash and Save are more than would be charged at most banks or credit unions, but less than at most fringe banks. While these services do meet the needs of the community, other identified needs such as access to credit have not been met. It does not provide loans or deposit accounts. Although there is a mechanism by which a client can open a deposit account at a Royal Bank branch, we were told that no one has used this option. Cash and Save is expected to realize a profit, although not as high as that of a typical bank branch.

The size and familiarity of an institution such as the Royal Bank is significant as it lends financial stability, financial and managerial expertise, and credibility to Cash and Save. However, from a community economic development perspective, realized profits mean resources extracted from a low-income community and transferred to middle- or high-income individual shareholders. The Cash and Save branch may be closed if it operates at break-even or a profit level that is less than targeted benchmarks set by global competitiveness and shareholder accountability obligations. The privately owned, for-profit model limits the scope and nature of services to those that are profitable as opposed to those that will have the great-

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<sup>17</sup> For a more extensive review and analysis of these programs, please refer to the full research report published by the Winnipeg Inner-city Research Alliance, "The Rise of Fringe Financial Services."

est impact and benefit to the community and its members. However, this model may prove to be the most sustainable in the long-term as independent financial viability is foundational to its mandate.

### **6.1.2 Four Corners Community Savings (Vancouver)**

The Four Corners Community Savings was opened in 1996 by the NDP provincial government to address the unmet financial service needs of Vancouver's Downtown Eastside. Four Corners provided deposit accounts with no minimum account balances, term deposits, cheque cashing, money orders, utility bill payments, electronic deposit of cheques, and no charges on ATM transactions.

However, Four Corners closed in the spring of 2004. It was unable to draw large accounts because accounts were not insured for more than \$2 million. This limited its ability to make loans—an important source of revenue. As well, the bank attempted to provide high per-unit transactions for no fees. The bank's initial \$10 million base capital, provided by the provincial government, had been eroded to near the required minimum of \$5 million. A new provincial government in 2002 terminated lending functions of the bank and introduced user fees in an attempt to make Four Corners viable, but these changes only led to decreased use of banking services. Attempts to secure tripartite funding failed, although the federal government did agree to fund building renovations, aimed at attracting non-profit tenants to share overhead costs, and the city bought the building and charges little to no rent to Four Corners.

A Four Corners respondent suggested that Four Corners would have been in a better position if it had not been subject to a heavy regulatory base as both a bank and a crown corporation; started small

with essential services with an eye to expansion later; and contracted out as many "backroom" operations as possible to organizations with established capacity and economies of scale.

Four Corners turned modern neo-liberal financial service trends on their head by charging lower fees to those who cost the bank the most, and higher fees to those who cost the bank less to service and who actually bring in revenues. Four Corners also sought to integrate meeting short-term and long-term community financial needs through services such as cashing cheques and by employing local individuals, providing financial counselling, encouraging savings, and integrating community organizations such as the job kiosk and community information displays into their service network. An innovative identification mechanism, where the client received a photo identification and Four Corners recorded it in their database, contributed to smoother delivery of services for both clients and the bank.

Four Corners also greatly increases the safety of the community (Bancroft Planning and Research Associates, undated). Fewer cheques are lost or stolen because they can be electronically deposited directly into clients' accounts. Additionally, access to money orders and deposit accounts has noticeably reduced the number of assaults and thefts in this neighbourhood. Reduced costs incurred to the taxpayer through the presence of Four Corners, in addition to the "social profit" benefits of the bank, should be considered in regards to the bank's "net worth."

However, it appears that Four Corners was conceived from a vision to serve the poor with the hope that the financing would somehow materialize. Unfortunately, an outlet focussed on providing individualized and inexpensive/free services to low-income clients will have a con-



siderable challenge soliciting funds or accounts that might actually make money. Also, as a program of the province, the bank was vulnerable to the political will of provincial leaders. The oversight of the economic perspective for the sake of the community perspective placed the bank in a precarious position from which it did not recover.

### **6.1.3 Desjardins *Caisses Populaire* Micro-loan Pilot Project**

The Desjardins *Caisses Populaire* (DCP) of Quebec is a centralized financial institution system that consists of *Caisses* (credit unions) across the province. It consists of 671 outlets and 5.16 million members with assets of \$85.3 billion (Desjardins, 2003). *Caisses* are federated together in the Federation des *Caisses Populaires du Quebec* (FCPQ). DCP has implemented a pilot project to provide small consumer loans to members who would not otherwise qualify for loans and to engage these members in financial planning. The FCPQ allocates a minimum of \$33,000 and a maximum of \$66,000 to a fund, which must be matched by the *Caisse* involved. The salaries of credit agents were paid by the government of Quebec during the first year and it split this cost with each local *Caisse* in the second year. The FCPQ is seeking to establish a foundation that would finance these salaries in the future.

Each loan fund is established by one or several local *Caisses* in partnership with a financial consulting agency (FCA). The FCA is considered to be a key element of the loan fund, as they screen out individuals not capable of participating and they also deliver the educational component of the process that empowers clients, increases their financial management skills, and increases the loan repayment levels. Of 488 financial consultations, 259 loans have been granted for an approval

rating of 51%. A total of \$131,279 has been lent, for an average loan size of \$527. The reimbursement rate is 92%. More than two-thirds of the clients had incomes of less than \$10,000 and 90% had incomes of less than \$15,000. The major reasons for the loans, in order of frequency, were: purchase appliances, pay utility bills, buy furniture, pay rent, consolidate debt, and purchase employment-related tools. Loan interest is capped at 5%, but only one *Caisse* has chosen to charge any interest at all.

In response to the nearly 50% of clients who apply and do not qualify for even these types of loans, some *Caisses* are planning to establish a parallel loan fund to meet these needs. This fund will not be self-sufficient and loans will be defined more as a donation. Recognizing that these loans would realize an even greater rate of default has not deterred the plan.

As demonstrated by the disinclination to charge interest, the perspective guiding the loan fund is not profit-oriented. The lack of loan interest charges, coupled with an 8% default rate, will mean that the fund will require permanent subsidization, which is only possible due to the size and strength of FCPQ and the partnerships under which the loan fund is administered. This administrative, financial, and stabilizing capacity is important for the delivery of the loan fund, as is the fact that, as a credit union, the mechanisms and capacity for administering financial transactions such as loans are well established.

## **6.2 Observations**

The diversity of community-based models providing financial services for low-income people reflects an important conundrum. Some models are profitable, yet provide fringe-like financial services. These services have limited scope to im-

prove the financial habits of their clients but the programs do not require an operating subsidy. Other models provide a wide selection of progressive financial services, but they are not profitable. In this case, low-income people who want to improve their financial habits have options; however, the programs require some sort of operating subsidy.

Financial services that contribute to individual financial health must address both the short- and long-term needs. Short-term services should include affordable access to small amounts of credit, cheque-cashing, and low-fee deposit accounts. Long-term services should address the conditions that underpin fringe financial service use. These services include savings plans, financial literacy, and money management education. In particular, access to credit, a mechanism by which to establish a good credit rating, and a mechanism to focus on savings and asset accumulation, are important.<sup>18</sup> To limit the mandate of the initiative to address only short-term needs like the Cash and Save does little in terms of education, capacity building, and asset accumulation. However, providing only long-term services, such as financial literacy, money management education, and asset building,<sup>19</sup> while integral to decreasing future reliance on fringe financial services, does not provide an alternative to the very real immediate needs of people in that community.

For this reason, the researched models demonstrate the integral nature of innovation, as affordable financial services

have not readily emerged from the private or public sector and yet the capacity required to deliver these services is beyond the mandate or capacity of most community-based, non-profit organizations. Cash and Save represents a market-based response, but it has no long-term or transformative component to its mandate. Four Corners represents a government intervention, but it failed to become viable. Desjardins has creatively designed a model that does meet both short- and long-term needs. Since it is a pilot project, it is not clear how effective this model will be in terms of transformative service provision and ability to cover its costs.

An important component of innovation is electronic transactions. Research by Four Corners revealed that community safety was increased as fewer people carried cash and cheques, and the cost to government for cheque replacement and the police- and health-related costs of thefts and assaults declined.

Other models have been set up as privately owned, for-profit initiatives and operated as “electronic kiosks” in convenience stores.<sup>20</sup> Some offered only a bill-payment service (free to the consumer, the utility company paid a small fee), and others also include cheque-cashing, money orders and transfers, and ATM functions. Future kiosks will include Internet access and will thereby facilitate all financial transactions that are possible on-line, including account management. Another development has been the “chip card” to replace the “swipe card,” which would carry account information on the card it-

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18 VanCity's low-limit VISA card secured by a term deposit is a good example of these three important components. See the full research report published by the Winnipeg Inner-city Research Alliance, “The Rise of Fringe Financial Services.”

19 For example, the Individual Development Accounts. See the final research report published by WIRA.

20 For instance, First American Credit Union set up a telecommunications micro-loan mechanism accessible within minutes at any ATM. See the final research report published by WIRA.

self. The “smart card” would have deposits transferred to it and payments transferred from it. As well, it appears that point-of-purchase debit machines will soon make it possible to make deposits to accounts at retail outlets.

The researched models also demonstrate that mobilizing multiple stakeholder participation has the potential to strengthen the capacity of the initiative, but it can also increase its vulnerability. Collaboration with various organizations and government can provide the model with diverse capacities, expertise, opportunities, multiple geographic locations, and spread the responsibility and risk for the model’s success to more than one lone entity. In fact, external funding may be the only possible way to deliver affordable financial services to the “un-banked.” However, dependency on government participation or partnering with organizations dependent on government funding can also render a model vulnerable to funding alterations or termination.<sup>21</sup> Four Corners would not have emerged had it not been for the leadership role taken by the government. But this, together with perpetual operating deficits, contributed to the termination of the model with the election of a new government that was not interested in subsidizing financial services for the public.

If the primary stakeholder is of considerable financial strength and capacity, as in the case of Royal Bank’s Cash and Save, and Desjardins, proceeding alone is possible and perhaps even preferable. But when the primary partner is of lesser capacity, the viability is greatly increased if

a bank or credit union is able to share the risk, contribute vital financial and technical expertise, contribute financial transaction capacity, and provide financial stability and depth for a model that may at times require subsidization. A credit union would be the most likely, given its community-oriented mandate. Although long-term viability is enhanced greatly if the model is self-sufficient, such a model may not return the profits demanded by bank shareholders, particularly in the formative and early operational stages. Additionally, credit union participation would increase the likelihood that any profits would be re-invested in that community.

The models do not clearly identify the nature of community participation required. Any model will likely require access to financial service economies of scale and will be subject to the vagaries of the market economy. Limited community participation may resemble consumer-profiling initiatives. Naturally, even from a market perspective, the model is doomed to failure without any community participation in the use of services. Many respondents stressed the importance of a community-oriented, “working with” approach to financial counselling, lending, and other financial services, although these are not integral to market-based success. Communicating with the client empowers the individual, allows them to feel heard and respected, allows the lender to get to know them as an individual, and provides an avenue to discuss alternative financial choices/strategies that may assist the individual. Desjardins stated that, through communication with

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21 For instance, Florida Central Credit Union, which partnered with Tampa Hillsborough Action Plan (THAP) to create an alternative financial service facility that provided payday and car title loans as well as cheque cashing. The partnership was key as it used the synergy of a strong financial institution merging capacities and strengths with a community development corporation. The initiative would never have materialized without the partnership, but the termination of THAP’s government funding led to the closing of the facility. See the final research report published by WIRA.

clients, credit agents were frequently able to find alternative solutions to loans. Four Corners emphasized the importance of personal service and dialogue that encouraged clients' capacity through a dignified

process that sought the best solution to the individual's circumstance, taking into account both the immediate and long-term needs of that person.

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## Summary and Recommendations

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### 7.1 Summary

This report documents research undertaken over the past year through the Winnipeg Inner-city Research Alliance to examine the rise of fringe financial services in Winnipeg's North End. Fringe financial services include a variety of financial services such as loans and cheque-cashing that are offered by fringe banks. Although fringe banks are becoming more common today, they generally operate on the margin of the mainstream banking and credit union system in Canada.

Fringe banks include pawnshops, cheque-cashing firms, payday lenders, rent-to-own firms, tax-refund advancers, finance companies, and "white-label" ATM providers. This report explores client experiences with fringe banks, examines the issue of fringe bank legitimacy, and develops a model and provides a preliminary feasibility assessment of an alternative model to fringe banks for low-income people. The research project has involved a series of methods: interviews with 41 North End fringe bank clients; interviews with 27 key informants with special knowledge about fringe banks and North End resident's financial needs; outlet follow-up and sample transactions; two focus group discussions; and a feasibility assessment.

The rise of fringe banks and their use is a complex phenomenon driven by broad changes in Canadian society and economy. Although many of these changes are broad processes, fringe banks have a particular impact on their clients, owners, employees, and neighbourhoods. The research project, rooted in a community-identified issue, has generated a significant understanding of the social and

economic impacts of fringe banking in the North End.

#### 7.1.1 Fringe Bank Client Experiences and Motivations

The motivations for using fringe banks are complex, varying among clients and across types of fringe banks. On the one hand, the clients we spoke with thought that fringe banks provided a needed service. These financial service outlets, such as cheque-cashing firms and rent-to-owns, are easy to access for a variety of reasons: clients generally do not need a bank account or the personal identification required for a bank account. Moreover, fringe bank outlets are nearby and have convenient hours of operation. Pawnshops provide clients with quick access to cash to meet emergency needs when other sources (e.g., bank, family or friends) are not available. In general, clients of these services had low incomes. Payday lenders and finance firms were used by a smaller number of our surveyed clients. Clients of these services reported similar accessibility motives as did other fringe bank clients, but they had higher incomes. Respondents also described using firms that provide tax-refund advances, and local stores and bars that provide credit and cheque-cashing services.

On the other hand, several of the fringe bank clients recognized the high cost of the services, in some cases deepening their debt load and aggravating a cycle of poverty. Some clients of cheque-cashing firms noted the high price they paid for this service. Some pawnshop clients were particularly aware of the relationship between pawning, debt, and poverty. Several rent-to-own clients noted the large

difference between the retail price as compared to the total payments they made for the item. Although in many cases clients do not know exactly how the fringe bank fee compares to mainstream bank services, they do understand that fringe financial services are more expensive.

Factors that correlated with the use of fringe banks include low income, low levels of formal education, single parenthood, and limited access to a mainstream bank and bank services. Some clients have difficulty physically getting to the bank, and others lack the personal identification required to open a basic account. Fringe bank clients commented that they felt more respectfully treated and that they had a greater sense of control over their money at fringe banks as compared to mainstream banks.

These motives and experiences help to explain the rise of fringe banks in the North End. The client research also revealed a variety of informal credit strategies undertaken by fringe bank clients. These strategies involve informal credit through family and friends that complements or substitutes for fringe bank credit. Fringe banking also has social effects in that it can trap low-income clients into a cycle of debt and poverty. This is aggravated by public policy that does not effectively address the causes of poverty, and community-based supports that are inadequate to deal with the scope of the challenge.

### **7.1.2 Characteristics of Fringe Financial Services and Outlets in the North End**

The data demonstrate a rise in the number of providers in both Winnipeg and the North End in the last 20 years, but particularly in the last five years. Cheque-cashers, payday lenders, rent-to-owns, and pawnshops are a growing sector.

Over the last 10 to 15 years, the North End has experienced a transformation whereby the number of mainstream bank branches has declined precipitously while the number of fringe banks has grown rapidly.

The costs associated with these services are high in terms of annualized interest rates: 450% for a \$50 to \$100 pawn; 210% to cash a cheque (assuming it is equivalent to a five-day loan); 675% for a \$100 payday loan; 305% for a rent-to-own agreement; and 286% for a tax-refund advance (assuming it is equivalent to a two-week loan). Fringe bank service costs are far in excess of comparable services offered by mainstream banks through deposit accounts, credit cards, and lines of credit. Moreover, fringe financial services meet only the immediate financial need; these services do not address longer term financial needs of their clients, such as savings and building a positive credit rating.

Many interviewed fringe bankers believe their clients have low incomes. Pawnbrokers and rent-to-own respondents believed the majority of their respondents are Aboriginal, and rent-to-own respondents indicated 85% of their clients were recipients of Employment and Income Assistance. Because of data limitations, we were not able to determine whether fringe banks generated profits beyond what is considered to be a fair or competitive rate of profit.

### **7.1.3 Legitimacy and Community Benefits of Fringe Banks**

In terms of fringe bank legitimacy, views expressed by key informants varied. Fringe bankers made the case for legitimacy in a variety of ways, most importantly that they follow fair business practices and that other “legitimate” businesses (e.g., corporations) also regularly

charge high fees for services. Fringe bankers report they are responding to a growing demand for their services. The fees charged, according to the fringe bank respondents, were high because of the risky and time-consuming nature of their business. A business-client tension was identified when fringe bank respondents were asked why their clients used fringe financial services instead of mainstream financial services: several commented that their clients made poor decisions.

Government views of fringe banks were mixed, particularly those of provincial government respondents who supported fringe banks in principle, but were unwilling to address particular cases of fringe bank overcharging and, when necessary, adjusting the fees to below the criminal rate of interest. The federal government respondent indicated that fringe banking is not in its jurisdiction in terms of policy, making the provincial perspective all the more important. Views expressed by community organizations were mixed regarding fringe bank legitimacy but a common concern was that the relationship with fringe banks does not help clients move out of poverty.

#### **7.1.4 Community-based Alternatives to Fringe Financial Services**

We considered three community-based models that provided alternatives to fringe banks. These models demonstrate the variety of approaches that credit unions, banks, governments, and communities have developed to address financial service needs of low-income people. Successful financial service models are complex in terms of the services they offer and the number of stakeholders involved. These services must face the need to (partly) pay for short-term services through user fees, but also address long-term financial service needs of low-income people. They also require support

from community partners, and financial and institutional support from government or mainstream banks.

## **7.2 Recommendations**

Recommendations from the research fall into three categories: services needed for North End residents; government policy related to fringe and mainstream banking; and further research. The recommendations must be understood in light of the limitations of the research size and scope, discussed in the research methods section.

### **7.2.1 Financial Services for the North End**

The research has documented that access to mainstream financial services in the North End has been declining as availability of fringe financial services has been growing. Fringe financial services can address the very short-term financial needs of some North End residents. However, these services are expensive and do not provide a direct way for clients to participate in financial services that address long-term need; e.g., savings and longer term credit. For this reason, we believe that access to mainstream bank services must be improved. We recognize that simply establishing new mainstream bank branches is unlikely, given the large-scale closures in recent years, and does not address the entire issue. Therefore, we propose the following.

**7.2.1.1** Community organizations should seek to raise awareness among North End residents about the costs, benefits, and limitations of fringe bank services, and the need to consider longer term financial strategies. This process could cast more light on client motives and generate social and political support for the development of alternative services more beneficial to clients in the long term.

7.2.1.2 Mainstream banks and credit unions remaining in the North End should be encouraged and supported to establish outreach services for residents of the North End who do not use their services because of a lack of awareness of the benefits. These mainstream banks could work with community agencies to better understand the needs of the North End clients and raise awareness about the benefits of mainstream banking. To be successful, the mainstream banks should address concerns expressed by North End clients about convenience, disrespect, and control over their funds.

7.2.1.3 The costs and practices of fringe financial services vary considerably. Community agencies might work with the fringe banks that offer the best rates and practices. These collaborative fringe bankers might be approached to explore the possibility of building ways in which their clients can make a transition to mainstream financial institutions.

7.2.1.4 Fringe bank clients who are dependent on Employment and Income Assistance should be made aware of the existing opportunities they have to save money. Savings by these people might be facilitated by addressing the second recommendation above, so that Employment and Income Assistance clients can establish savings accounts at mainstream banks.

## 7.2.2 Government Policy

We have identified two general areas of government policy requiring reform. Poverty and stagnating incomes at the low end of the income scale have facilitated the demand for fringe financial services. Thus, the growing dependence on fringe banks suggests a need to re-examine broad social policy. Second, the rapid rise

of fringe banking has meant that government policy needs to “catch up” with the economic reality. In Manitoba, regulation of fringe banking is limited and ad hoc.

7.2.2.1 We believe that growing dependence on fringe banks is partly the result of poverty and stagnating or declining incomes. Thus, policies and regulations affecting the incomes of low-income people must be addressed. For instance, the provincial government could move to a guaranteed minimum income program. Alternatively, the government could raise the rates of Employment and Income Assistance. The government could also address the needs of low-income people through greater subsidies in housing, health care, and child care.

7.2.2.2 The Manitoba government should seek ways to help people move from Employment and Income Assistance to employment. This transition can be facilitated if Employment and Income Assistance recipients can save in order to invest in education and employment. The government should clarify with clients, and reform the rules for savings, to facilitate a transition out of dependence on Employment and Income Assistance.

7.2.2.3 The Manitoba government should consider introducing a photo-identification card that could be used for mainstream bank identification. Moreover, the province could require, as is done in British Columbia, that mainstream banks cash provincial cheques—e.g., Employment and Income Assistance cheques—for free.

7.2.2.4 The federal government must address the declining availability of mainstream banks in inner-city neighbourhoods by developing legislation that requires mainstream banks to contrib-



ute to these communities. The Community Reinvestment Act (see Caskey 1994, p. 133) in the US is an example of this type of legislation. Of course, to attract people to a mainstream bank from a neighbourhood like the North End requires the physical establishment of the bank *and* outreach operations. Federal policy could require that all mainstream banks contribute to inner-city and rural communities across the country.

**7.2.2.5** The federal agency, the Financial Consumer Agency of Canada, should take a proactive stance regarding the fringe bank phenomenon. The agency's mandate includes the education of consumers about financial services. Given the rise in fringe banks, and the decline of mainstream banks in inner-city neighbourhoods, the agency must address the educational needs of inner-city residents. This can be achieved through research and education programs offered through community agencies and schools. It is unlikely that this education can be achieved through the agency's Web page.

**7.2.2.6** The provincial government should introduce new legislation regulating all fringe banks, including pawnshops, cheque-cashers, payday lenders, rent-to-owns, income-tax refund advancers, finance companies, etc. This legislation should establish a system of fair disclosure requiring firms to use a consistent system of pricing and advertising so that consumers can easily and understandably compare prices between firms. Regulations should also limit loan rollovers or extensions, and restrict firm collection practices related to defaulted loans. The government might also introduce a recommended annualized interest

rate for small-sum, short-term loans.<sup>22</sup> This could be based on further research, described below.

**7.2.2.7** At present, pawnshops in Winnipeg are more regulated than the other fringe banks. This regulation is undertaken by the city and deals with zoning and monitoring of transactions of stolen goods. Other than the issue of stolen goods, it is not clear why pawnshops face more regulation than other fringe bankers. Our research demonstrates that clients benefit from pawnshop services. The research team recommends that fair disclosure legislation, described above for fringe banks in general, should apply also to pawnshops. If the proposed Internet-based monitoring system increases the cost of pawning for consumers, then the rationale for the program must be very clear. At present, even the best monitoring system is limited by people's propensity not to keep records of their serial numbers.

### **7.2.3 Further Research**

With any research project, several questions are answered and many new questions arise. This is the case with the present research project. We have tried to address the three research objectives dealing with fringe bank overcharging, fringe bank client motivations, and the feasibility of a community-oriented alternative to a fringe bank. However, we recognize that not all the questions on these issues have been addressed and that new questions have arisen.

**7.2.3.1** Because the client research was conducted using a chain-referral method in the North End with only 41 respondents, the research project cannot make universal statements about

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<sup>22</sup> In France, the government posts usury interest rates at banks and financial institutions. Lenders cannot charge interest rates above this usury interest rate.

the results. There is a need for a broader survey of fringe bank clients across Winnipeg and possibly across the country.

**7.2.3.2** The research team could not find studies examining the fringe bank phenomenon generally in Canada. There is a need for studies to examine the growth, services, and costs of fringe banking across the country. This study might include an examination of the connection with mainstream branch closures, argued by Caskey (1994) in the US case.

**7.2.3.3** While this research project did not address fringe bank policy directly, it became clear that there is a need for more research in this area. We recommend that further independent research be conducted related to provincial and federal government policy regarding this sector, to consider the impact on the low-income fringe bank consumer.

**7.2.3.4** Another policy issue indirectly addressed in this study and that requires further research relates to general social policy for low-income people. What is the relationship between social policy and dependence on fringe financial services? How can

social policy be reformed to encourage a transition to mainstream financial services?

**7.2.3.5** Fringe banks are increasingly operating in middle-income neighbourhoods in Winnipeg. Research might examine this phenomenon and compare it with the rise of fringe banks in low-income neighbourhoods. More generally, fringe banks are becoming more common and therefore more mainstream. A research study could examine the consequences for clients in this process of normalization of a new sector. A related question would be to examine the social perceptions in Canada towards fringe bankers.

**7.2.3.6** Research might be conducted into the costs of providing small-sum, short-term loans. These data could be used to help consumers evaluate their options in terms of fringe financial services.

**7.2.3.7** Research might examine the impact of fringe bank establishments on a neighbourhood. For instance, a study might look at the consequences of establishing a pawnshop on a neighbourhood's businesses, sense of community, housing quality and prices, etc.

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