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The Promise of On-Demand Access to Earned Wages

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Introduction

For an array of reasons, many people find themselves in need of cash before their next payday. Until recently, those who could not borrow from family or friends typically had few options: high-interest credit card debt, predatory payday loans, costly overdrafts, and the like. None of these addresses one of the root causes of paycheck-to-paycheck shortfalls: the rigidity of paydays themselves.

Every time an employee works, they earn wages, accruing pay for 40 hours, 80 hours, or even up to 184 hours (if working full-time at a job that pays monthly) before receiving their paycheck. Such extended periods between paychecks can create challenges and household budget shortfalls, especially for low-wage workers who must contend with regular financial pressures and minuscule margins of error.

A recent market-based solution has emerged with the belief that wages earned should be available to workers on demand, regardless of when payday is. Providers of earned wage access (EWA) and direct-to-consumer (D2C) advances say they bridge the gap between paydays without the high fees of other market offerings, enabling users to pay bills on time, save more, and increase financial stability.

This issue brief explores the challenge of short-term illiquidity for household finances and evaluates the promise of EWA and D2C advances, considering not only the data and business models but also the behavioral implications of these products. Because research suggests that poverty itself causes cognitive impairment, this brief evaluates how traditional market solutions exploit that impairment and how EWA and D2C advance products could help alleviate it.[1] Finally, this brief outlines the need for regulators and lawmakers to define the scope of these products so that they can continue to innovate and develop into broadly accepted and accessible tools that promote financial security.

Financial Vulnerability, Cognitive Lapses, and Predatory Solutions

For workers living paycheck to paycheck, paying a bill due at an inopportune time can be a serious challenge, even when the bill is expected.[2] Moreover, this is not a rare occurrence: One survey of 1,000 salaried workers in the United States earning less than $75,000 a year found that nearly 50% of respondents reported at least an occasional shortfall between paychecks.[3] And the effects of such a shortfall can extend beyond employees to their employer: In one recent poll, 76% of employees who reported facing financial stress said that such stress had a negative impact on their productivity at work.[4]

Illiquidity between paychecks results, in part, from the rigidity of the traditional pay cycle. Norms surrounding pay cycles—the frequency with which employers pay employees—have evolved over time and vary between employers, but the concept of a periodic payday predominates, with 68% of private employers issuing paychecks biweekly, semimonthly, or monthly.[5]

To make optimal personal financial decisions, virtually everyone must overcome blind spots, oversights, and the prolific use of mental shortcuts.[6] But a liquidity crisis depletes an individual's cognitive capacity, attention, and executive control—the resources needed to pay close attention, plan for the future, and remember deadlines and important tasks.[7] This depletion hampers one's ability to invest time in or effort into increasing earnings, increases the likelihood of making short-term financial mistakes that might exacerbate financial difficulties, and even hinders day-to-day functioning.[8]

> "Even those who earn annually a bit more than they spend, if on some days there is not enough cash to handle expenses, they must then resort to payday loans, pawn shops, and overdraft fees, with the accompanying high interest, shame, and stress. Avoiding these menacing consequences demands unrelenting attention, constant monitoring, and carefully calibrated spending. As it turns out, a person focused on doing all that has less cognitive resources left for other things, from attending to peripheral matters, to self-control and long-term planning."
>
> **– Anandi Mani, Sendhil Mullainathan, Eldar Shafir, and Jiaying Zhao[9]**

The stakes are highest for those with the least room for error.[10] For households living paycheck to paycheck, errors, financial shocks, and misalignment between when bills are due and when pay is received are more common and more consequential than for the financially secure.[11] Thus, liquidity—cash that is available to use immediately—is exceptionally important for those with low-to-moderate incomes (LMI), but it is often in short supply.

When tight finances curtail the ability to think clearly about the future, short-term preferences can easily outweigh long-term interests. Just as the impulse to skip a workout today can often overwhelm the desire to be more fit next month, the need for liquidity today can outweigh the aversion to large fees or credit card debt next week, not to mention the desire to save money for the future.[12] Further compounded by a lack of resources, these "time-inconsistent preferences"—behavior that values our future needs far less than our current wants—can often make pernicious liquidity solutions attractive. Unfortunately, the two primary income-smoothing instruments traditionally available to low-income Americans, hourly employees, and the unbanked—credit card debt and payday loans—often carry extremely high costs.

TRADITIONAL MARKET "SOLUTIONS" DO MORE HARM THAN GOOD

In theory, both credit card debt and payday loans help provide needed liquidity to underbanked and LMI populations. But providers of short-term liquidity often exploit the effects of financial stress on cognition and rely on customers to misunderstand loan structures and overestimate their ability to repay loans on time, turning these instruments into debt traps for borrowers.[13]

Fourteen percent of U.S. adults say they would cover a $400 emergency expense by charging it to a credit card and paying it off over time.[14] But while credit cards provide nearly frictionless liquidity for the 84% of adults who have one, they often do so at a high cost.[15] According to one survey conducted in the fourth quarter of 2021, nearly half of people with income between $25,000 and $99,999 had carried a credit card balance at least once in the previous 12 months.[16] The average annual percentage rate (APR) on such a balance was 19.1% in the second quarter of 2022.[17] As a result, the Consumer Financial Protection Bureau (CFPB) estimated that Americans paid roughly $120 billion per year in credit card interest and fees between 2018 and 2020—around $1,000 a year per U.S. household.[18]

The cost of a payday loan can be even higher, but 12 million Americans annually report using them.[19] Payday loans are typically taken out for amounts under $500 and are due in full on the borrower's next payday (usually within two to four weeks).[20] The cost of a payday loan is generally around $15 per $100 borrowed, equating to an APR of nearly 400%—although in some states, the

typical APR on a $300 loan can exceed 650%.[21] Even in states that limit payday loan fees, payday lenders have begun partnering with out-of-state banks to issue loans with prices that exceed those limits.[22]

Moreover, many borrowers cannot afford the lump-sum repayment required on payday loans and so borrow against subsequent paychecks, leading to a debt trap of repeated borrowing and additional fees.[23] Nearly 25% of payday loans are re-borrowed nine times or more, and the average borrower ultimately takes five months to pay off their loan—far longer than the advertised two weeks and at much higher cost.[24] And although payday loans advertise their services as being helpful for unexpected or emergency expenses, 70% of borrowers use them for regular, recurring expenses such as rent and utilities.[25]

Recognizing the important role that market solutions can play in addressing short-term illiquidity, state-level regulators have worked to provide guardrails for consumers with some success. For example, comprehensive payday loan reforms in at least four states have saved consumers millions of dollars in fees while maintaining access to short-term credit.[26] But the patchwork of regulations and the persistence of payday lenders' attempts to circumvent rules call for both continued efforts on this front and the facilitation of innovative alternatives in the market.

An Alternative: On-Demand Access to Earned Wages

Promising innovation includes employer-integrated EWA and D2C advance products, and the market for these products has grown rapidly in recent years, nearly tripling from $3.2 billion to $9.5 billion between 2018 and 2020.[27]

Employer-integrated EWA providers partner with companies to offer their service as an employee benefit. By integrating with an employer's payroll and timecard systems, these EWA providers leverage verified payroll data to allow employees to access their wages as they are earned.[28] In addition to companies that have emerged to provide EWA services such as DailyPay, Even, and Payactiv, long-established payroll providers such as ADP and Ceridian now offer employer-integrated EWA.

The leading employer-integrated EWA providers offer fee-free options, but if workers want their wages instantly, workers must typically pay a fee of around $3 to $5 each time they request wages before payday.[29] The provider's integration with a user's payroll information is the principal reason EWA fees are mini-

mal—such a link has led to a default rate of less than 20% of that expected by credit scoring.[30] On top of these negligible losses, EWA providers face low operating costs because much of their service is app-based and automatic.[31] Some EWA providers also have alternate funding streams, such as interchange fees on purchases made with their prepaid cards.

As many businesses continue to struggle to find and retain employees, EWA has become an attractive new benefit for employers to offer.[32] In one sign of EWA's staying power, Walmart—which has been offering EWA to its workforce since 2017—purchased its EWA provider Even in January 2022.

Increased employer adoption may help the EWA industry continue to grow and stake a claim as a financially responsible alternative to payday loans and similar options. With EWA as a workplace benefit, employers have incentives to engage with the service providers to ensure that EWA creates real value for workers. This provides a stark contrast to payday loans and credit card debt—financial tools that are separate from users' sources of income. Such employer engagement might help to keep relative user costs down and terms of service fair while spurring continued innovation and improvement.

In contrast to employer-integrated EWA, D2C advance providers market their service directly to workers without employers' involvement.[33] These providers, including Earnin and Dave, offer advances to workers on their accrued wages that they then recoup directly from the borrower's bank account on payday. Because D2C advance providers do not have access to employers' payroll data, they instead use customer-provided time sheets, paychecks, transaction and deposit history, or cellphone geolocation data (confirming the time a worker has spent at their job) to verify eligibility for advances.[34]

Like EWA companies, D2C advance providers face low overhead costs because their service is largely app-based and automatic. Without direct access to users' paychecks, however, D2C advance providers possibly face somewhat higher rates of non-repayment. For revenue, D2C advance providers rely primarily on subscription fees of anywhere between $1 and $10 per month and on per-advance "tips" from users, where the default tip is often set around $7.[35] Although these tips are voluntary, consumer advocates have raised concerns that it is difficult for users to avoid paying them.[36]

Table 1 summarizes some of the main features and differences between the two industry models.

Table 1. Features of Employer-Integrated EWA and D2C Advance Products

	Employer-Integrated EWA	D2C Advance
Customer Acquisition	Employer chooses EWA provider for its employees	Consumer selects D2C advance provider
Wage Estimation	EWA provider determines employee's net wages based on payroll data from the employer	D2C advance provider estimates customer's income based on past deposits or uploaded time sheets
Fees	Employee pays fee set by EWA provider for services (or employer pays fees for employee)	Customer pays subscription fee (in most cases) and a voluntary "tip" for each advance
Fund Delivery Method	Employee receives funds on payroll card or into bank account	Customer receives funds into bank account
Fund Recovery	EWA providers work with employers to recoup wages accessed early via payroll deduction on the next payday	D2C advance provider debits customer's bank account on their next payday

Source: BPC review of provider websites

THE PROMISE OF EARNED WAGE ACCESS AND DIRECT-TO-CONSUMER ADVANCES

A variety of improvements over current market options for short-term liquidity make EWA and D2C advances compelling alternatives. Of critical importance to consumers, most of these services provide access only to wages already earned, charge nominal transaction fees, and integrate directly with the pay cycle, presenting virtually no risk of falling into a debt trap.[a] These same features make EWA and D2C advances much more flexible than payday loans, which often have minimum loan requirements to compensate for the industry's higher default rates and operating costs.

EWA and D2C advances, along with the suite of financial wellness products offered by most providers, are also likely to enhance users' ability to manage their finances. For example, many EWA and D2C advance services provide streamlined and user-friendly access to one of the most important commitment devices in personal finance: automatic saving.[37] Broadly, commitment devices create a cost for failing to act in the future as one wants to act now. One exam-

a Many EWA and D2C advance providers enforce (or allow employers to enforce) stringent limits. Employer-integrated EWA users can typically access between one half and all of their earned wages, while most D2C advance providers use proprietary underwriting models based on users' recurring deposits and past expenses to set advance limits, typically ranging from $50 to $500.

ple is telling a friend that you will donate $100 to the charity of their choice if you skip any workouts while training for a marathon. This creates a financial as well as a psychological cost to skipping a workout if you fail to follow through on the donation (the loss of your friend's respect and the charity's benefit).

An automatic saving feature serves as a commitment device because humans find it psychologically costly to deviate from a set course of action.[38] Once a worker sets an automatic transfer of, for instance, 5% of each paycheck into a savings account, the effort required to stray from this chosen path or the fear of making a choice that could lead to a loss of some kind down the road works strongly against reducing that amount. Moreover, tracking one's accumulated savings over time can provide a strong psychological reward for maintaining—or even increasing—one's saving rate.

The ability of workers using EWA and D2C advance apps to track their wages on a daily (or even hourly or per-shift) basis may have a similar effect, psychologically strengthening the relationship between work and earnings and thereby enhancing incentives to work.[b]

Given such strong evidence of the products' benefits (both alone and as part of the suite of tools offered by most providers), it is perhaps no surprise that research finds the service can significantly enhance employee retention and recruitment, especially for lower-earning workers.[39]

Case Study: DailyPay

DailyPay, founded in 2015, is a leading provider of EWA and other payroll services. Its products (and those of some other EWA providers) allow workers to track and access their income as it is earned, as well as track spending and save directly from their paycheck.[40]

A May 2021 survey of DailyPay customers suggested that using DailyPay significantly mitigated the need to resort to high-cost sources of short-term liquidity.[41] Of the 21% of respondents who reported taking out payday loans before using DailyPay, 81% said they stopped using payday loans entirely and 15% reported reduced use of payday loans after adopting DailyPay.[42] Eighty-eight percent of those respondents credited the use of DailyPay for the change.[43] Aite-Novarica Group, which DailyPay commissioned to conduct the study, estimated that DailyPay

b According to one EWA provider's 2022 internal data, approximately 35% of users access the platform to track their earnings without engaging in a financial transaction. These users can monitor their earnings daily, and some do so even more frequently, based on the data integration with their employer.

saved frequent payday borrowers between $624 and $930 a year.[44]

Of the 39% of respondents who reported overdrawing their bank account before using DailyPay, 79% said they overdrew their account rarely or never after using DailyPay, and 75% of those respondents credited the use of DailyPay for the change.[45] Aite-Novarica Group estimated that DailyPay saved frequent overdrafters $660 a year.[46]

Surveys also found significant benefits to employers that adopted DailyPay, finding that the tool motivated 59% of respondents to go to work and 56% of respondents to pick up more shifts or work longer hours.[47] A report produced by Payactiv provided further evidence: After one company began offering its product as an employee benefit, attrition over a 60-day period dropped by 25%, with the greatest effects on millennials and low-wage workers.[48]

A TRUST-BUILDING DISRUPTION?

Americans' trust in financial institutions has trended upward since 2012 but remains low, with only one-third (31%) of people saying they trust those institutions overall.[49] Research suggests that a lack of trust has negative effects on individuals' financial security, as it can encourage some to withdraw their savings from banks, makes many hesitant to invest in riskier assets such as stocks, reduces portfolio diversification, and diminishes demand for expert advice.[50]

As digital platforms continue to drastically improve user experiences, traditional financial service providers find themselves closely competing with increasingly popular fintech providers. In a recent survey, 37% of consumers said that fintech companies were their most-trusted financial services brand, higher than both banks (33%) and wealth management firms (12%).[51] Younger generations report even higher levels of trust in fintech services: 51% of respondents ages 18-24 and 49% of respondents ages 25-34.[52]

Fintech providers, such as DailyPay, Payactiv, Earnin, PayPal, and Venmo, have attracted consumers by better attuning their services to meet varied financial needs. In particular, these companies seek to simplify their products to maximize ease of use, which consumers want when opting-in to innovative financial solutions.[53] Traditional banking institutions, in contrast, have in many cases been slower to offer comparable online alternatives and fully adapt to the new customer-service-centric culture of banking.[54]

In addition, consumers value data protection, high-quality products and

service, and the ability to meet their financial goals all on one site. Fintech companies have embedded those features into their platforms, making them more appealing to consumers seeking new financial tools and solutions.[55] This intentional relationship leads to greater community trust, which has allowed new services, such as EWA and D2C advance, to break into these markets.

The increased transparency of EWA and D2C advance providers also attracts consumers because they are better able to anticipate fees or costs up front compared with alternative options. Moreover, many EWA providers that charge a flat fee per transaction and offer employer-integrated solutions are developing updated programs that eliminate many fees.[56]

Impact of D2C Advances on Mental Health and Financial Outcomes

- In 2021, a poll of D2C advance users found a significant positive impact on users' mental health and feelings of control over their finances—as well as on the frequency with which users face overdraft fees.[57]
- 21% of respondents said they felt more in control of their finances after using D2C advance services than they did before.
- 82% of respondents reported that using D2C advance services made them feel less stressed about their financial situation; 81% reported increased self-esteem, and 77% reported improved mental health.
- 82% of respondents said D2C advance services had helped them save money on overdraft fees.

Consumer Protection Concerns Remain

Some consumer advocates consider EWA and D2C advance products to be thinly veiled credit, subject to many of the pitfalls of payday loans and other predatory financial products.[58] These critics argue that EWA and D2C advance should be subject to laws, such as the Truth in Lending Act, meant to protect consumers from unfair or deceptive financing by requiring interest rate limits,

ability-to-pay analysis, and other safeguards.[59]

Few, if any, regulations are directed at EWA and D2C advances, but providers are eager for regulatory certainty. The CFPB issued an advisory opinion in November 2020 on employer-integrated EWA programs, which resolved some regulatory uncertainty regarding the application of the Truth in Lending Act and the various requirements it imposes on credit providers to certain EWA programs.[60] Notably, however, the CFPB has not weighed in on the D2C advance model.

The advisory opinion stipulated that certain employer-integrated programs that provide EWA funds to an account of the employee's choice; recover the transaction through a payroll deduction; do not charge or accept fees (except for nominal processing fees); do not assess credit risk or report to credit bureaus; and meet other factors are not credit—and therefore are not covered by the requirements of the Truth in Lending Act.[c,61] As a result of continued and ongoing discussion among industry representatives, public officials, and consumer protection advocates, the CFPB announced in June 2022 that it plans to issue further guidance soon.[62]

Two competing views have historically dominated the discourse surrounding the regulation of EWA and D2C advance providers. One perspective is that these services are functionally the same as payday lending, offering money today to be repaid on payday, sometimes with a fee.[63] The other view is that they simply provide employees flexibility in when they can access the wages they have already earned.[64]

Ongoing uncertainty regarding whether EWA and D2C advances are credit—and, therefore, whether they are subject to the patchwork of laws that govern credit—inhibits continued development, innovation, and widespread adoption. But the dispute is not trivial.[65] If courts or regulators decide that these offerings are loans, then the companies offering them must become licensed lenders in many states, comply with state and federal laws regulating loans, obey relevant legal restrictions, and comply with state usury limits and other laws, all of

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c The specific criteria that a product must meet to not be considered credit are: (1) The provider contracts with employers to offer and provide EWA transactions to the employer's employees; (2) The accessible balance does not exceed the accrued cash value of the wages the employee has earned up to the date and time of the transaction; (3) The employee makes no payment, voluntary or otherwise, apart from nominal processing fees, to access EWA funds or otherwise use the service, and the provider does not solicit or accept tips or any other payments from the employee; (4) The provider recovers the amount of each EWA transaction only through an employer-facilitated payroll deduction from the employee's next paycheck; (5) In the event of a failed or partial payroll deduction, the provider retains no remedy against the employee; (6) The provider clearly and conspicuously explains the transaction has no fees, there is no recourse, and there is no debt collection or reporting to credit bureaus; and (7) The provider will not directly or indirectly assess the credit risk of individual employees, such as through credit reports or credit scores.

which could result in substantial product modifications, substantially increased costs (and, in turn, fees), and unavailability based on conflicting or ill-fitting new requirements.[66]

To resolve this uncertainty, the federal government, through either regulation or legislation, should clarify the key requirements and consumer guardrails that differentiate an EWA or D2C advance product from credit by answering the following questions:

- Should employer-integrated EWA and D2C advance products be evaluated differently from a regulatory standpoint, including on the question of whether they are credit?
- What standards or best practices should exist regarding income verification?
- What fees or voluntary payments can EWA and D2C advance providers charge or accept without becoming lenders?
- What guardrails should exist in legislation or regulation to protect consumers?
- What clarifications to existing tax law, such as the issue of constructive receipt, are needed to help those employers who offer EWA products for their workers?[d]
- Can the use of EWA or D2C advances affect consumers' credit scores?

To realize the promise of this fast-growing industry while protecting consumers, the Treasury Department, the CFPB, and Congress must act soon to resolve these questions.

STATES TAKE THE LEAD

EWA and D2C advance products also face headwinds in the states, where a patchwork of licensing requirements, payroll regulations, and usury laws complicate efforts to provide uniform services nationwide, including to companies with interstate operations.

California's Earned Income Access Service Providers Act of 2019 was the first significant attempt to regulate the EWA and D2C advance industry, but the legislation collapsed as it ballooned to cover all kinds of fintech products.[67] Instead,

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d According to the IRS, "Income is constructively received when an amount is credited to your account or made available to you without restriction." Income constructively received is subject to income tax, meaning an individual cannot, for example, avoid paying tax on income in one year by delaying its deposit until the next year. See IRS Publication 538 for more detail.

California enacted the California Consumer Financial Protection Law in 2020, empowering its Department of Financial Protection and Innovation (DFPI, previously known as the Department of Business Oversight) to regulate consumer financial products and services such as EWA.[68] Shortly after, DFPI signed first-of-their-kind memoranda of understanding (MOUs) with certain EWA and D2C advance providers, allowing the companies to continue operating while delivering DFPI quarterly reports on several metrics related to their business.[69] As part of the MOUs, some companies also agreed to submit to periodic inspections and to follow certain practices, including:[70]

- Not making their product offering contingent on any tips the consumer chooses to make or not make;
- Disclosing the APR, if any, on the advance pay to the consumer before advancing the funds;
- Limiting the APR, if any, to 36%;
- Disclosing any potential fees to the consumer before advancing the funds;
- Disclosing the risk of overdraft charges to the consumer before advancing the funds; and
- Capping the advance at 50% of the consumer's next anticipated paycheck.

Since 2020, legislatures in at least eight states have considered bills on this segment of the fintech industry, most of which would provide limited safe harbor for employer-based EWA providers but not for D2C advance providers.[71] Proposed legislation in New York, for example, would permit employer-integrated EWA providers to operate and charge fees contingent on their registering with the state and complying with various other consumer protection measures.[72] The bill would stipulate that amounts paid by employer-integrated EWA providers would not be considered a loan and, therefore, associated fees would not be considered interest. D2C providers, on the other hand, would be considered lenders and be subject to relevant state and federal statutes governing credit. Proposed legislation elsewhere would require EWA providers to recoup advances through payroll and therefore prohibit any D2C advance operators.[73]

Although none of these bills has passed, state attorneys general have begun to act. Most recently, Arizona's attorney general concluded that neither EWA nor D2C advance products meets the definition of a consumer loan because the products are fully non-recourse (i.e., the provider does not engage in any debt collection activities if it is unable to recoup any portion of an advance) and do not charge interest or levy any finance charge (a term that excludes the nominal fees that EWA and D2C advance providers do charge).[74]

Conclusion

EWA and D2C advance providers have successfully disrupted the market for short-term credit by offering an alternative to high-cost options—namely, low-cost access to earned wages between paydays. These providers—whether working hand-in-hand with an employer or directly with the consumer—can help workers manage income volatility by recognizing the behavioral biases and tendencies that people face when economic stresses force them to weigh today's financial needs against tomorrow's financial wellbeing.

Although the pay-cycle landscape has begun to modernize, the concept of payday remains, continuing to cause short-term illiquidity and financial hardship for millions of low-income, hardworking Americans and their families. Increased access to and uptake of EWA or D2C advances could help if the products prove to be responsible alternatives to payday loans and other such options.

Because the industry is not yet directly regulated, there is no better time for lawmakers to educate themselves on the promise the industry offers—as an innovation that can expand access to financial services and build financial security, particularly among low-to-moderate-income households—and on the important consumer protection considerations it raises.

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