New Regulation on the Horizon for the Payday Lending Industry

Hanah Harris-Yager
Student Fellow
Institute for Consumer Antitrust Studies
Loyola University of Chicago School of Law

Recent activity in the Consumer Financial Protection Bureau (“CPFB”) indicates that the agency will be issuing proposed regulations for the payday lending industry in the near future. The regulations come as a result of months of research on the topic by the agency, as well as consumer complaints and a number of enforcement actions. In the absence of federal regulation, the states have been working to address fraud in the industry and to protect consumers from potentially harmful payday lending practices.

Payday loans are advertised as short-term loans which provide necessary, stop-gap financial assistance to borrowers who do not otherwise have access to credit.¹ The loans get their name from the fact that they are taken out as an advance on the borrowers’ earnings and are typically due on the borrowers next payday.² Payday loans are generally for $500 or less. A balloon fee payment is required at the onset of the loan, in an amount which can range from $10 to $30 per $100 borrowed.³ The typical loan fee, with $15 in fees per $100 borrowed, equates to an annual percentage rate of almost 400%. Payday loans are generally structured to be repaid in a single, lump-sum payment. Borrowers who cannot pay the full amount of the loan frequently roll-over their principal balance by taking out a new payday loan with new fees.

¹ CONSUMER FINANCIAL PROTECTION BUREAU, PAYDAY LOANS AND DEPOSIT ADVANCE PRODUCTS, 6 (2013).
³ PAYDAY LOANS AND DEPOSIT ADVANCE PRODUCTS, supra note 1 at 8-9.
I. Consumer Financial Protection Bureau

In a recent speech, the Director of the CPFB, Richard Cordray, announced that the agency is “in the late stages” of developing rules which will reform the payday lending industry. Cordray criticized the industry harshly, calling payday loans “debt traps” and characterizing loan fees as “a heavy yoke that impairs a consumer’s financial freedom.” Cordray went on to say that “[t]he business model of the payday industry depends on people becoming stuck in these loans for the long term, since almost half of their business comes from people who are basically paying high-cost rent on the amount of their original loan.”

A recent report issued by the agency revealed some startling facts about the payday lending industry. The report was issued at the same field hearing where Director Cordray announced the impending regulations. The CPFB found that more than 80% of payday loans are rolled over into another loan or renewed within 14 days. Many borrowers find themselves trapped in these “short-term” loans for months; 15% of new loans are followed by loan sequences which include at least 10 rolled-over or renewed loans. Most of the loans issued by payday lenders were renewals following a previous loan, rather than distinct borrowing episodes. Half of all loans issued are part of a loan sequence of at least 10 loans. These statistics indicate that, for the majority of borrowers, payday loans are not short-term lending devices. It is likely that these findings will inform the actions of the CPFB and state legislators.

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5 CONSUMER FINANCIAL PROTECTION BUREAU, CPFB DATA POINT: PAYDAY LENDING (2014).
7 CPFB DATA POINT, supra note 11 at 11.
The CPFB began accepting complaints regarding payday loans only five months ago.\(^8\)

Shortly after that, the agency initiated the first enforcement action against Cash America International, Inc., one of the largest short-term, small-dollar lenders in the country.\(^9\) Cash America violated the Military Lending Act by charging illegal interest rates to service members and for robo-signing court documents in debt collection lawsuits.\(^10\) As a result of that action, Cash America was required to pay $5 million in fines and up to $14 million to affected consumers.\(^11\)

The CPFB partnered with state attorneys general for the first time in an investigation of illegal activity in the payday lending industry over a year ago.\(^12\) The Attorneys General of Hawaii, New Mexico, North Carolina, North Dakota, and Wisconsin joined the investigation and lawsuit against Payday Loan Debt Solution, Inc. (PLDS). The joint investigation found evidence to suggest that PLDS routinely charged consumers unlawful fees. PLDS routinely charged consumers fees in advance of actually settling their debts, a violation of the Consumer Financial Protection Act.\(^13\) A federal district court held that PLDS violated both federal and state consumer protection laws.\(^14\) PLDS was required to pay restitution to its consumers and $5,000 in a civil money penalty. That case marked the first time that the CPFB coordinated its efforts with state attorneys general. In recent remarks to the National Association of Attorneys General,

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10 Under the Military Lending Act, interest rates on loans to active service members and their families are capped at 36%. 10 U.S.C. § 987(b).

11 Our First Enforcement Action Against a Payday Lender, *supra* note 18.


13 12 U.S.C. 5531(a)

Director Cordray indicated that the CPFB was interested in “building and strengthening” its partnerships with state attorneys general to work on payday lending and other consumer concerns.15

II. States

Payday lending is heavily restricted in 14 states and the District of Columbia, where state usury laws have effectively eliminated payday lending.16 In the states which allow payday lending, legislatures and other state actors are taking action to protect consumers.

A. Idaho

Idaho Gov. Butch Otter recently signed a bill which would limit payday advances to 25 percent of the borrower’s monthly income.17 Lenders are required to request income information from borrowers in furtherance of this goal. The bill also requires lenders to provide adjusted repayment plans upon request, free of additional fees or interest. Repayment plans must consist of at least four installment payments over the course of not less than 60 days. Borrowers may request an extended repayment plan once a year.

B. Illinois

Illinois Attorney General Lisa Madigan recently filed four lawsuits against unlicensed, online payday lenders for violations of the State’s Payday Loan Reform Act.18 The defendants,

16 SAFE SMALL LOANS RESEARCH PROJECT, PEW CHARITABLE TRUSTS, STATE PAYDAY LOAN REGULATION AND USAGE RATES, 1 (2014).
BD PDL Services LLC, Mountain Top Services LLC, Red Leaf Ventures LLC and VIP PDL Services LLC, are all out of state lenders with online payday lending operations.

The Payday Loan Reform Act was passed in 2011 and applies to all lenders offering or making payday loans to consumers in Illinois.\(^{19}\) The Act limits the fees a payday lender can charge a consumer.\(^{20}\) Payday lenders cannot issue a loan to a consumer if the loan would result in their being in debt to one or more payday lender for more than 45 consecutive days, and must wait seven days before issuing a loan to a repeat customer, once their loans are paid off.\(^{21}\) The Act also requires lenders to provide borrowers with a disclosure pamphlet detailing their rights under state law and advising them of the availability of alternative debt management services.\(^{22}\)

The cases against the four payday lenders are very similar. The Attorney General’s Office alleges that the defendants charged Illinois residents with fees of up to $30 per $100 borrowed.\(^{23}\) As unlicensed lenders, the defendants did not have access to the State’s payday loan databases and therefore failed to verify that the loans were being issued to eligible borrowers. The Attorney General’s Office requested a permanent injunction from the Court preventing the lenders from offering or making loans to Illinois residents until they become compliant with state law. In addition, the complaints request that all the payday loan contracts with Illinois residents be declared null and void and that each lender be assessed a civil penalty in addition to restitution.

\(^{19}\) 815 ILCS 122/1-15(a).
\(^{20}\) 815 ILCS 122/2-10(a).
\(^{21}\) 815 ILCS 122/2-5(b).
\(^{22}\) 815 ILCS 122/2-20(a).
C. Louisiana

The Louisiana Senate is currently considering a bill which would limit payday lenders to issuing ten loans per borrower per year.\textsuperscript{24} The bill follows an attempt earlier this month to pass a bill which proposed a 36% cap on annual interest rates for small loans; but the bill died in committee.\textsuperscript{25}

D. Minnesota

In Minnesota, a bill is being considered in the state House which would prohibit lenders from issuing more than four loans to a given borrower in a year.\textsuperscript{26} If the bill is passed, lenders would be required to determine that the borrower has the ability to repay the loan. In addition, lenders would be prohibited from issuing loans which would increase the borrower’s total debt-to-income ratio to more than 41 percent. A similar bill in the Senate would limit borrowers to eight loans per year and imposes a 45-day waiting period between loans.\textsuperscript{27}

E. Missouri

The Missouri Legislature is currently considering a bill which would cap the amount of fees and interest imposed by lenders to 35% of the amount of the loan.\textsuperscript{28} This is a significant decrease from current law, which allows lenders to charge fees and interest of up to 75% of the amount of the loan.\textsuperscript{29} The bill would also prohibit lenders from renewing loans.\textsuperscript{30} Instead,
lenders would be required to offer an extended repayment term of up to 120 days to borrowers struggling to repay their loans. All payday lending stores would be required to post notice of the availability of extended repayment programs.

III. Alternatives for Consumers of Small Loans

As they await new federal regulation and state laws, many consumer advocates are beginning to consider how payday loans can be replaced with fair, low-cost alternatives. In January, the Office of the Inspector General (OIG) of the U.S. Post Office publishes a report which proposed that U.S. Post Offices be adapted to provide non-bank financial services. The report proposes that the U.S.Post Office be authorized to make small personal loans to eligible borrowers and specifically notes the public interest purpose of providing alternatives to traditional payday loan establishments. Under the OIG proposal, borrowers would be provided access to loans equal to 50% of their gross income per paycheck. Loans would be repaid over the course of several months, depending on the amount, with an average annual interest rate of 28%. Although the authorization of such a plan is likely years away, the OIG’s proposal has already caught the attention of some influential consumer advocates; Elizabeth Warren publically endorsed the proposal only a week after its release.

32 Id. At 12.