A Survey of Small Dollar Lending, State Law Trends, and CFPB Action

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I. Introduction

The legal landscape of small dollar lending regulation is in a near-constant state of change, with regular amendments to the governing laws at the state level and the likelihood of significant regulation by the Consumer Financial Protection Bureau ("CFPB") on the horizon. Small dollar lending takes many forms, including payday lending, title lending, small dollar installment lending, and deposit advance loans. This article summarizes the basic structure of these small dollar loans, addresses the state law trends impacting small dollar lending generally, and examines the role of the CFPB in small dollar lending moving forward.

II. Payday Lending

The CFPB currently defines payday loans, also referred to as deferred presentment transactions or small loans, as generally having three common features: (1) the loans are for low dollar amounts, typically not more than $500; (2) they are typically made for a very short term, often becoming due at the borrower's next paycheck; and (3) they involve either the writing of a check to be cashed by the lender on the maturity date or granting the lender access to the borrower's checking account to initiate a withdrawal on the maturity date.[1] However, individual states vary regarding the parameters of what constitutes a payday loan.[2] For example, Idaho defines a payday loan as a transaction pursuant to a written agreement between a creditor and the maker of a check whereby the creditor: (a) accepts a check from the maker; (b) agrees to hold the check for a period of time prior to negotiation, deposit or presentment; and (c) pays to the maker of the check the amount of the check, less the authorized fee.[3] However, Idaho law also restricts the maximum principal balance that a payday lender may have outstanding to a single borrower at $1,000.[4] Louisiana, in turn, defines a deferred presentment transaction as a transaction made pursuant to a written agreement whereby a licensee: (a) accepts a check from the issuer dated as of the date it was written; (b) agrees to hold the check for a period of time not to exceed thirty days prior to negotiation or presentment; and (c) pays to the issuer of the check the amount of the check less the permitted fee.[5] Louisiana limits the maximum principal balance of a deferred presentment transaction to $350.[6]

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[1] *See What is a Payday Loan?*, Consumer Financial Protection Bureau (Nov. 6, 2013), http://www.consumerfinance.gov/askcfpb/1567/what-payday-loan.html. We also note that the CFPB may change its definition when it promulgates rules governing payday lending.
[2] *See* Nat'l Conf. State Legislatures, *Payday Lending State Statutes* (Sept. 12, 2013), *available at* http://www.ncsl.org/research/financial-services-and-commerce/payday-lending-state-statutes.aspx.
[3] Idaho Code § 28-46-401(1).
[4] Idaho Code § 28-46-413(1).
[5] La. Rev. Stat. § 9:3578.3(2).
[6] *Id*.

The charges permitted for payday loans also vary by state, but typically permit fees between ten and twenty percent of the principal balance.[7] In addition, payday loans often involve the use of a renewal feature, which is sometimes also referred to as a rollover or an extension. Typically a borrower utilizes a renewal to pay a fee to delay paying back the full balance owed on the loan.[8] Some states impose additional requirements on renewals. For example, Missouri requires that the borrower pay down the principal balance owed on the loan by at least five percent with each successive renewal and limits the maximum number of renewals to a total of six.[9] Other states, like Illinois, expressly prohibit renewals.[10]

III. Title Lending

Title loans are a form of small dollar lending in which a borrower takes a loan against the equity in their motor vehicle. Typically, but not always, title loans are only granted to borrowers who do not have any outstanding liens on their motor vehicle. A title loan is usually accomplished by the borrower giving the lender physical possession of the title to the borrower's motor vehicle.[11] The term of a title loan is generally relatively short.[12] However, the term requirements for title loans vary more by state than do the term requirements of payday loans.[13] Moreover, some states allow the renewal of title loans in a similar manner as payday loans.[14] The typical rates and charges range from 120% per annum[15] to an unlimited interest rate.[16]

IV. Small Dollar Installment Lending

In addition to the specific types of small dollar loans described above, many states have regulated traditional installment loans under a certain dollar threshold. These laws, typically referred to as a "Small Loan Act", contain provisions specific to loans below the threshold and require licensure by the lender. For example, Arizona requires licensure and compliance with certain substantive requirements for all lenders making consumer loans of $10,000 or less to Arizona consumers.[17] However, some states only regulate small dollar installment loans if the interest rate exceeds a certain threshold. For example, Massachusetts regulates the business of making consumer loans of $6,000 or less, but only if the interest rates on such loans exceed twelve percent per annum.[18] The permissible interest rates generally range from 17% to 36% per

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[7] For example, Alabama permits a fee equal to 17.5% of the principal balance of the payday loan. Ala. Code § 5-18A-12.
[8] *See What Does it Mean to Renew or Roll Over a Payday Loan?*, Consumer Financial Protection Bureau (Nov. 6, 2013), http://www.consumerfinance.gov/askcfpb/1573/what-does-it-mean-renew-or-roll-over-payday-loan.html.
[9] Mo. Code Regs. Tit. 20, § 1140-11.030(8).
[10] *See* 815 Ill. Comp. Stat. § 122/2-30.
[11] *See* 38 Ill. Admin. Code § 110.300.
[12] For example, South Dakota provides that the term of a title loan may not exceed one month. S.D. Codified Laws § 54-4-71.
[13] For example, Wisconsin law allows title loans to be made with a term up to six months. Wis. Stat. § 138.16(1)(c). In contrast, Virginia requires that the term of a title loan be at least 120 days, but not more than twelve months. Va. Code § 6.2-2215(1)(c).
[14] *See* Tenn. Code § 45-15-113(a).
[15] Ariz. Rev. Stat. § 44-291(G).
[16] Mo. Rev. Stat. § 367.515.
[17] Ariz. Rev. Stat. § 6-601(7).
[18] Mass. Gen. Laws ch. 140, § 96. *See also* N.Y. Banking Code § 340 (regulating lenders making consumer loans of $25,000 or less at interest rates exceeding sixteen percent).

annum, but some states do allow higher rates of interest and permit the assessment of creditor-retained fees that result in significantly higher disclosed Annual Percentage Rates.[19] In addition, many small dollar installment lenders obtain significant compensation relating to the sale of add-on products, such as credit insurance and debt cancellation products.

V. State Law Trends

Payday lending is an area of the law subject to regulatory change at the state and local level. Over the past five years, a number of states have substantially limited or eliminated the authority of payday lenders. For example, New Hampshire enacted payday loan legislation effectively eliminating the industry in 2008 by limiting the Annual Percentage Rate to 36%.[20] Further, after the Arkansas Supreme Court held that the Arkansas payday loan statute constituted unconstitutional usury in 2008,[21] the Arkansas legislature subsequently repealed the entire Arkansas payday loan law in 2011.[22] In addition, some municipalities have passed ordinances regulating payday lending at the city or county level, which creates substantial compliance concerns.[23]

Many states have also continued to amend existing payday loan laws, even if they have not repealed them in their entirety. A common legislative amendment in recent years has been to limit the number or frequency of payday loans that may be taken out by a single borrower. For example, in 2012 Delaware passed a bill limiting the number of payday loans that a single borrower may take out to five in a given 12-month period.[24] Payday lending legislation is currently being discussed in Alabama, Arizona, and Missouri. These trends are likely to continue for the foreseeable future, with significant public pressure being placed on small dollar lending, particularly on payday lending.

VI. CFPB Action

A. CFPB Focus

The CFPB has been gearing up to regulate payday lending at the national level. The CFPB has indicated that the CFPB is in the late stages of developing proposed rules governing payday lending and a proposed rule will be issued in late 2015.[25] The CFPB previously

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[19] For example, Arkansas has a 17% per annum interest rate limit. Ark. Code § 4-57-104; Ark. Const. Amendment 89, § 3. In contrast, New Hampshire permits licensed lenders to assess an interest rate of 36% per annum. N.H. Rev. Stat. § 399-A:12(I).

[20] H.B. 267, 88th Senate and House of Rep., Reg. Sess. (N.H. 2008) (enacted).

[21] *See McGhee v. Ark. State Bd. of Collection Agencies*, 289 S.W.3d 18 (Ark. 2008).

[22] S.B. 259, 88th Gen. Assem., Reg. Sess. (Ark. 2011) (enacted). Note that the Arkansas payday loan law was titled the Arkansas Check-Cashers Act.

[23] For example, Dallas, Texas requires licensing and compliance with substantive regulations for payday lenders making loans to Dallas residents. *See* Dallas Code of Ordinances, Ch. 50, Art. XI.

[24] *See* H.B. 289, 146th Gen. Ass. (Del. 2012) (the Delaware law also amended the existing "workout" plan provided by statute to require that lenders offer an interest free "workout" plan allowing borrowers to pay off their balance with interest free installments if they cannot pay at the maturity date).

[25] *See* Payday Loans and Deposit Advance Products (Spring, 2015), http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201504&RIN=3170-AA40.http://www.consumerfinance.gov/blog/category/payday-loans/

published a Data Point Report on payday lending, which reviewed data received from storefront payday lenders over the course of a 12-month period.[26] The Data Point Report indicates that the CFPB is focusing on renewals and their effect on borrowers. Specifically, the CFPB examined the degree to which repeat borrowers may become caught up in a cycle of debt, rather than using payday loans on an emergency or short term basis only.

The Data Point Report included information on approximately twelve million loans across thirty states. The CFPB noted that over 80% of payday loans were rolled over or followed by another loan within 14 days.[27] The data showed that, although a majority of loan sequences are short, the majority of payday loans were part of long sequences.[28] Borrowers who were paid more frequently (i.e. borrowers paid weekly, bi-weekly, or twice a month) typically took out more loans in a given time period than borrowers paid less frequently (i.e. borrowers paid monthly).[29] Over 40% of borrowers who were paid monthly were involved in a loan series for the entire 12-month period reviewed by the CFPB.[30] Relatively few borrowers reduced the principal amount borrowed between the first and last loan of a sequence.[31] Payday loan borrowers who re-borrowed monthly were much more likely to stay in debt for at least 11 months. The majority of monthly borrowers were also government benefits recipients.[32]

The CFPB's data report also separated payday loan borrowers into three categories: (a) repayers were borrowers who neither defaulted on nor renewed their payday loans in the 12 month period; (b) defaulters were borrowers who defaulted on a loan during the 12 month period examined; and (c) renewers were borrowers who did not default and who renewed at least one loan within a period of 14 days after repaying a prior loan.[33] Of the borrowers examined, 64% of new borrowers became renewers, 20% became defaulters, and 15% became repayers.[34] Of the repayers, 61% took out only one loan during the time period.[35]

B. CFPB Examinations

Section 1024(a)(1)(E) of the Dodd-Frank Act gives the CFPB authority to supervise and examine non-depository payday lenders: :[T]his section shall apply to any covered person who – (E) offers or provides to a consumer a payday loan." The CFPB also indicates it will rely on its authority to regulate unfair, deceptive, and abusive acts or practices under section 1031(a) of the Dodd-Frank Act to address activities by payday lenders that meet any of those criteria.[36] The CFPB also examines payday lenders for compliance with the following Federal laws, among

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[26] *CFPB Data Point: Payday Lending*, the Consumer Financial Protection Bureau: The CFPB Office of Research (Mar. 2014), http://files.consumerfinance.gov/f/201403_cfpb_report_payday-lending.pdf.
[27] *Id*. at 4.
[28] *Id*. at 12.
[29] *Id*. at 14-15.
[30] *Id*. at 14.
[31] *Id*. at 16.
[32] *Id*. at 14.
[33] *Id*. at 25.
[34] *Id*. at 26.
[35] *Id*.
[36] CFPB, Examination Procedures, Short-Term, Small-Dollar Lending at 4-5 (Sept. 2014), available at http://www.consumerfinance.gov/guidance/supervision/manual/.

others: Truth in Lending Act, Fair Credit Reporting Act, Fair Debt Collection Practices Act, and Equal Credit Opportunity Act.

VII. Conclusion

The law surrounding small dollar lending is changing almost daily as the CFPB and states focus attention on this industry. Additionally, states' attorneys general are actively investigating and prosecuting small dollar lenders and their service providers, at least those that operate online without attempting to comply with the law of the states where borrowers reside.[37] Recognizing this important and changing area of the law, the Consumer Financial Services Committee has created a Task Force on Small Dollar Lending to monitor these developments and keep committee members up to date.

[37] *See, e.g.*, Illinois Attorney General Lisa Madigan*, Madigan Cracks Down on Unlicensed, Predatory Payday Lenders* (Apr. 8, 2014), *available at* http://www.illinoisattorneygeneral.gov/pressroom/2014_04/20140408.html; Attorney General Eric T. Schneiderman, *A.G. Schneiderman Announces Settlement With Western Sky Financial And Cashcall For Illegal Loans Made Over The Internet* (Jan. 24, 2014), *available at* http://www.ag.ny.gov/press-release/ag-schneiderman-announces-settlement-western-sky-financial-and-cashcall-illegal-loans.