



S.J. QUINNEY
COLLEGE OF LAW

THE UNIVERSITY OF UTAH

*Bank Liability for Processing
Illegal “Payday” Loan
Payments*

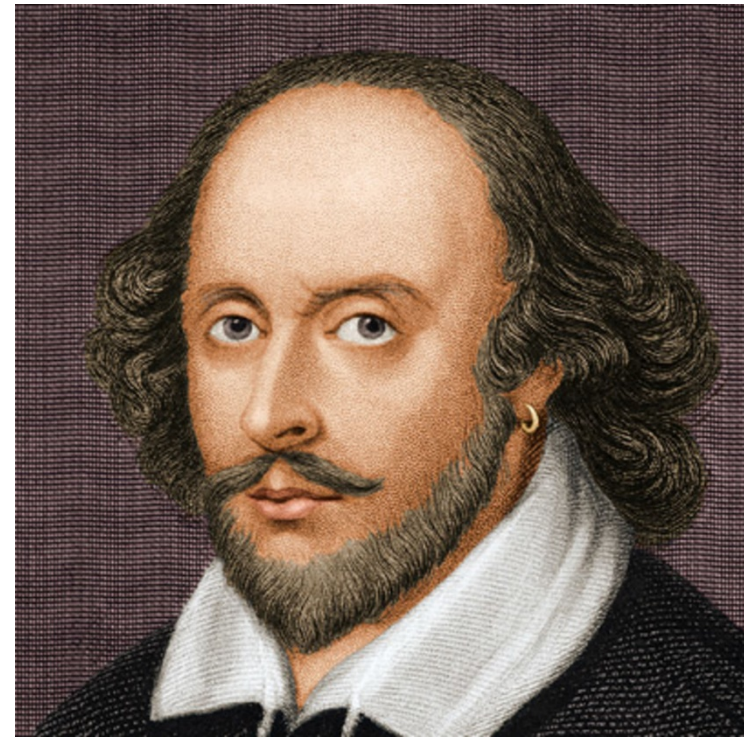
Christopher Peterson

John J. Flynn Endowed Professor of Law

Populism in Consumer Finance

Roman Citizen:

Care for us! True, indeed! They ne'er cared for us yet: suffer us to famish, and their store-houses crammed with grain; make edicts for usury, to support usurers; repeal daily any wholesome act established against the rich, and provide more piercing statutes daily, to chain up and restrain the poor. If the wars eat us not up, they will; and there's all the love they bear us.



W. Shakespeare

Can banks be held liable for processing payments for illegal loans?

- Background:
 - Payday lending: Markets and State Law
 - Payment Processing Systems
- Challenges in Bank accountability
- CFPB Oversight
- Policy Recommendations

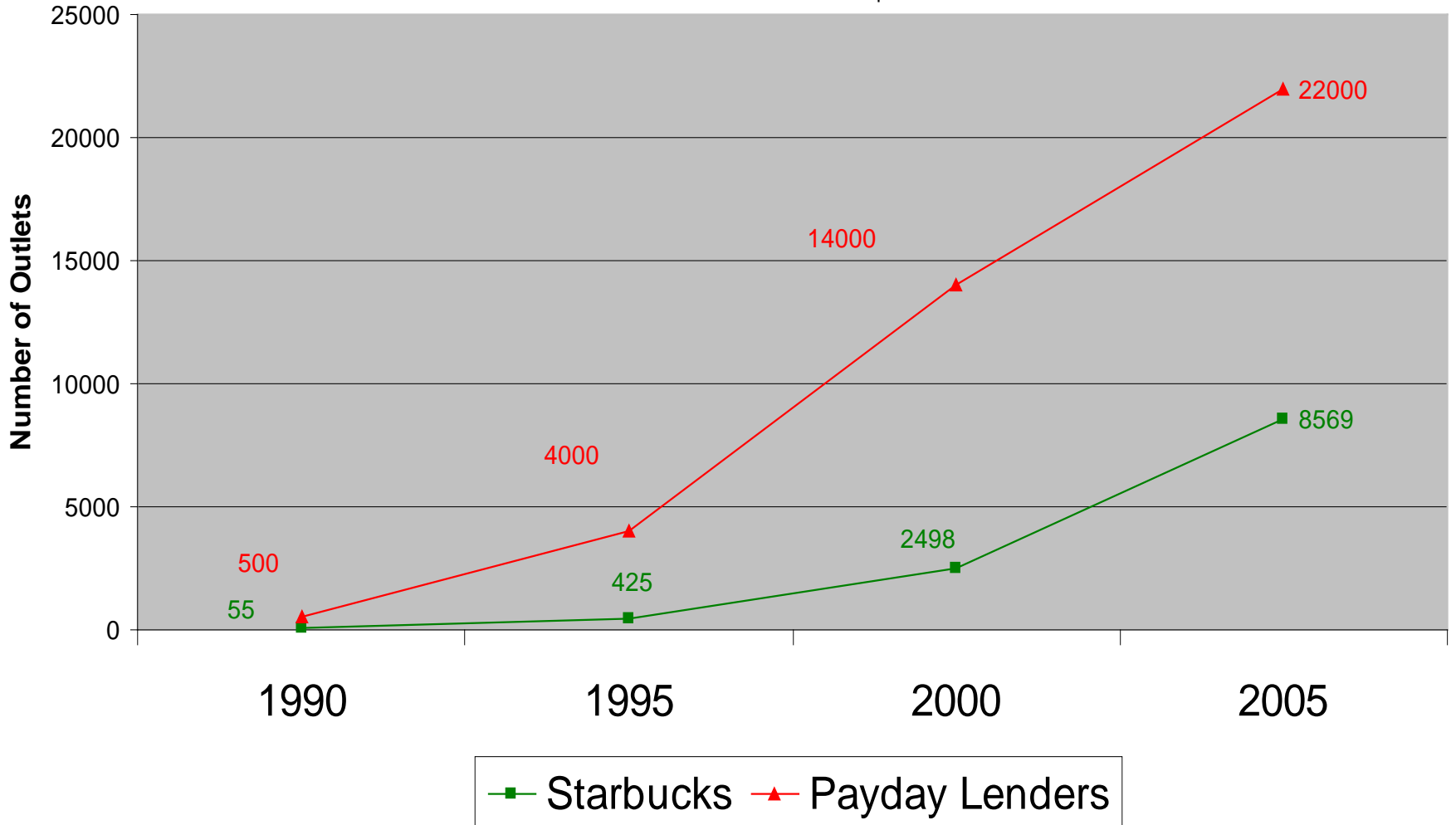
Payday Loans in the Deregulatory Era of American Usury Law

How do payday loans work?

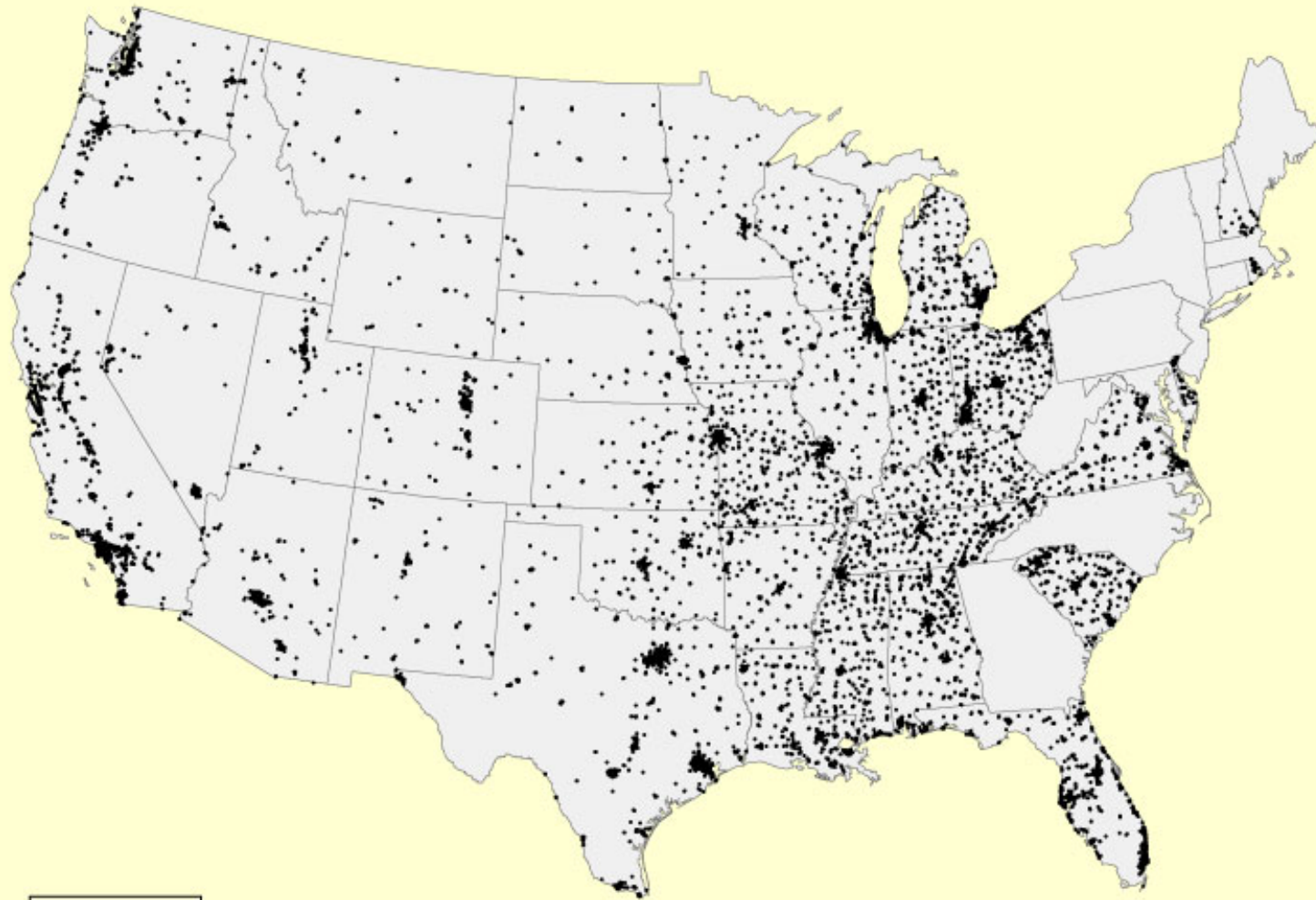
- Average simple nominal annual interest rates are around 450 percent.
- Payday loans tend to evolve in to recurring debt patterns.
- The average customer repays \$793.00 for a \$325.00 loan.
- Payday loan customers are often members of groups that can least afford high credit prices.

Nationwide Growth of Starbucks vs Payday Lenders

*sources listed with spreadsheet



Payday Lenders- 2007

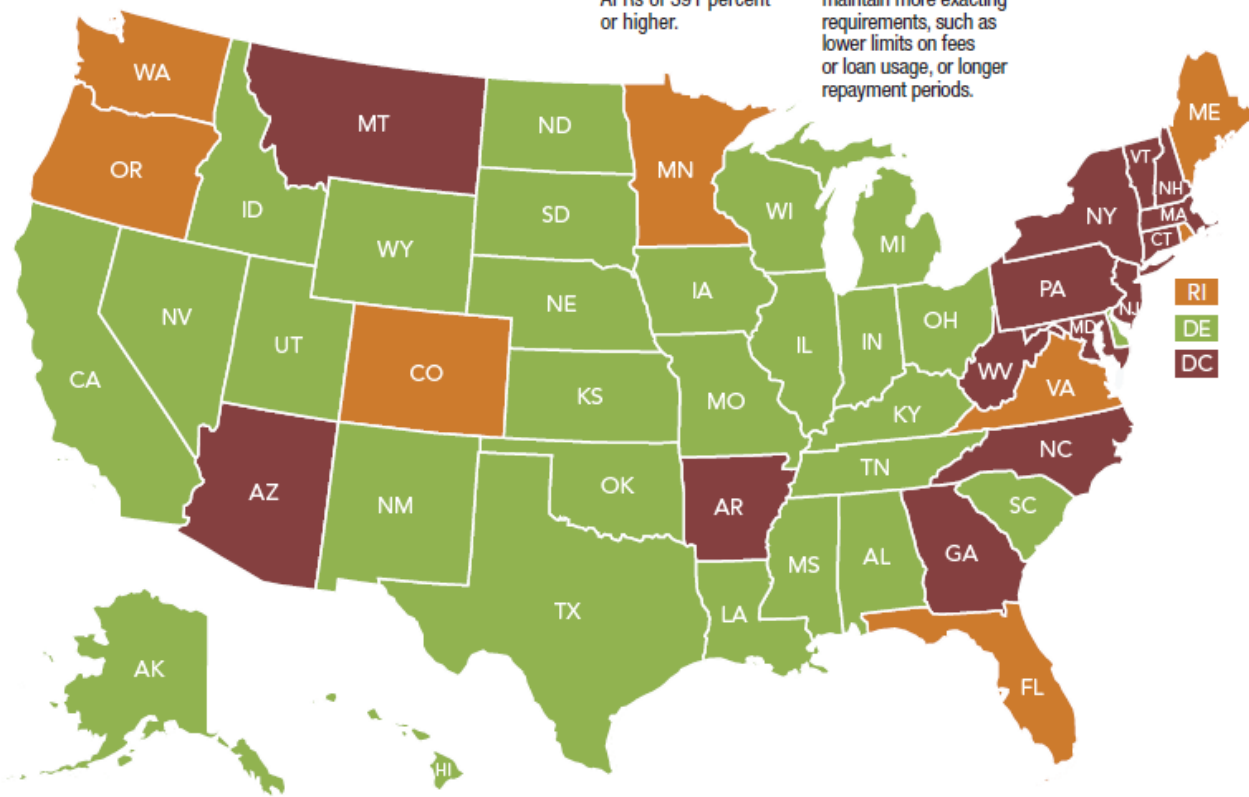
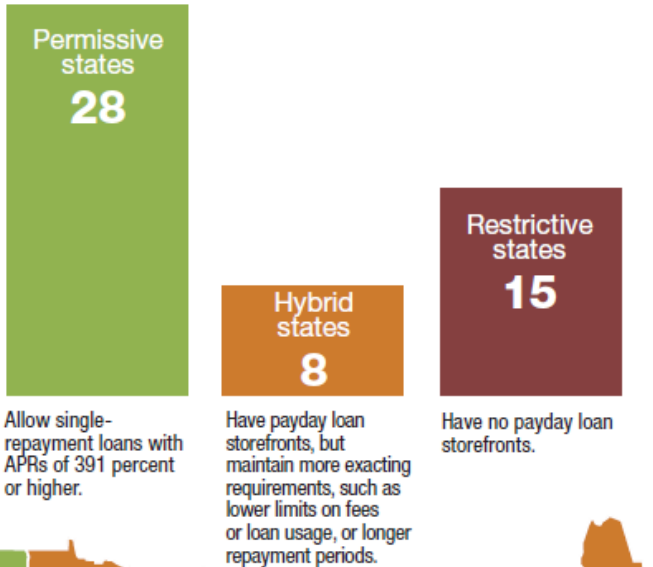


• Payday Lender

Source: State Regulatory Authorities,
telephone directories

EXHIBIT 6:
**HOW STATES
 REGULATE
 PAYDAY LENDING**

States have deployed a variety of strategies designed to prohibit, control, or enable this form of small-dollar credit.



SOURCE: Pew Safe Small-Dollar Loans Research Project, 2012.

Cross-border online payday lending transactions

- Online payday lenders locate in regulatory haven jurisdictions and attempt to ignore borrower state usury limits and licensure laws.
 - Tribal partnership lending
 - Offshore lenders
 - Kansas City

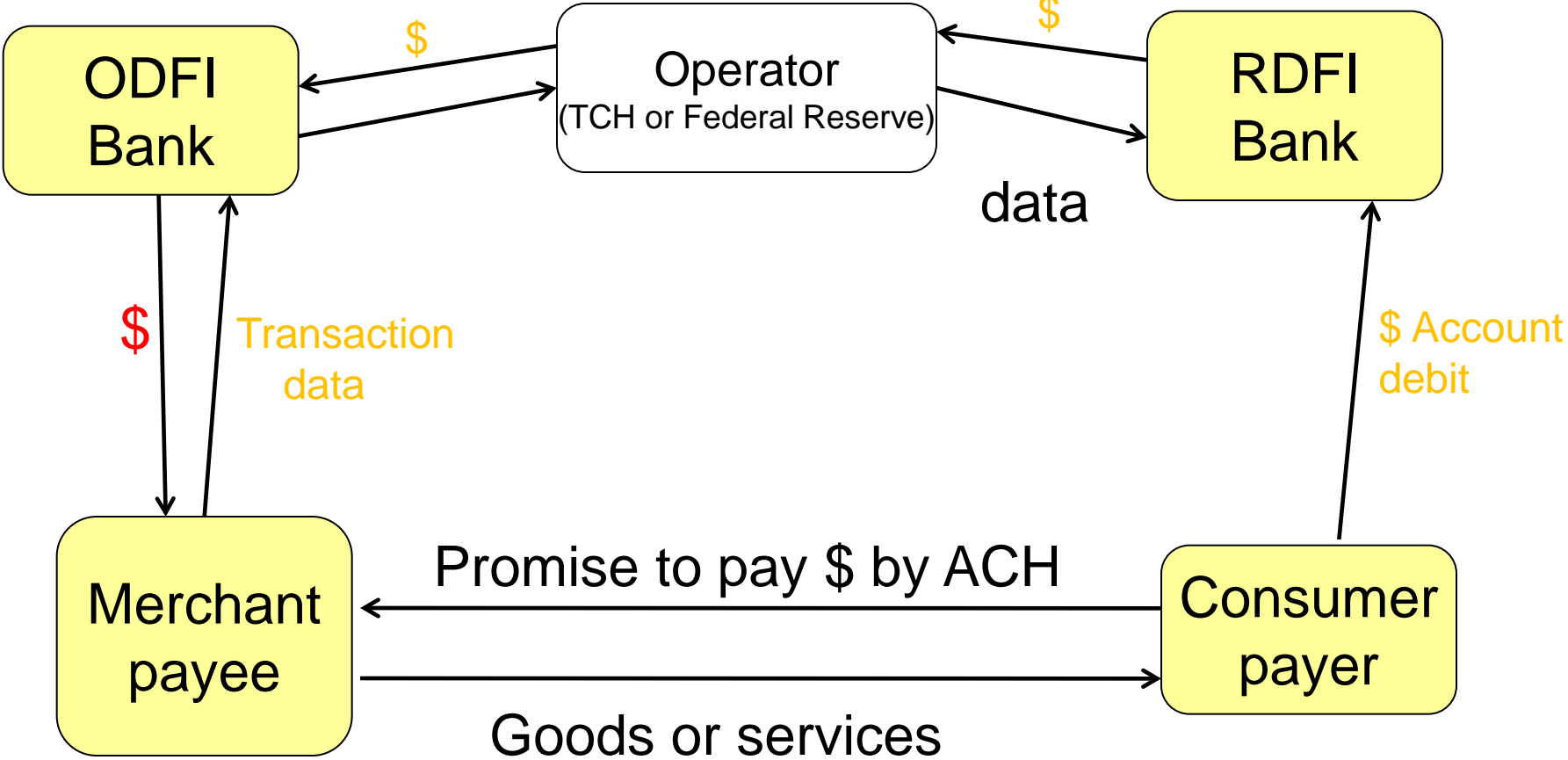
Federal Racketeering Statute

- On-line payday lenders may be violating criminal usury laws in some northeastern states.
- On-line payday lenders may be violating federal RICO law.
 - 18 U.S.C. § 1692(c). “It shall be unlawful for any person employed by or associated with any enterprise engaged in . . . collection of unlawful debt.”
 - 18 U.S.C. § 1691(6). “**unlawful debt**” means a debt (A) ... which is **unenforceable** under State or Federal law in whole or in part as to principal or interest **because of the laws relating to usury**, and (B) which was incurred in connection with ... the business of lending money or a thing of value at a rate usurious under State or Federal law, **where the usurious rate is at least twice the enforceable rate**”
- Pending Prosecutions of online payday lenders (and their attorneys) in SDNY and EDNY

Federal and State Unfair and Deceptive Trade Practices Laws

- Federal UDAAP Laws
 - CFPB's CashCall case
- State UDAAP Laws
- State Usury limits

ACH System



ODFI Banks should be accountable for taking reasonable steps to exclude merchants that illegally process payday lending payments

- ODFI banks have a natural advantage in monitoring the activity of their payment processing clients.
 - ODFI Banks already must monitor for money laundering, terrorism.
 - ODFI Banks have a financial incentive and are required by law to monitor the solvency of their payment processing clients.
 - Payment processing clients are willing to cooperate with ODFI banks because the merchant needs the access to payment networks that only financial institutions can provide.

ODFI Banks should be accountable for taking reasonable steps to exclude merchants that illegally process payday lending payments

- Misalignment of ODFI banks' incentives and consumer welfare.
 - Consumers usually do not turn to the ODFI bank for any banking services.
 - The ODFI does not have any financial skin in the game in an illegal payment between from a consumer to a merchant that is engaged in illegal activity.

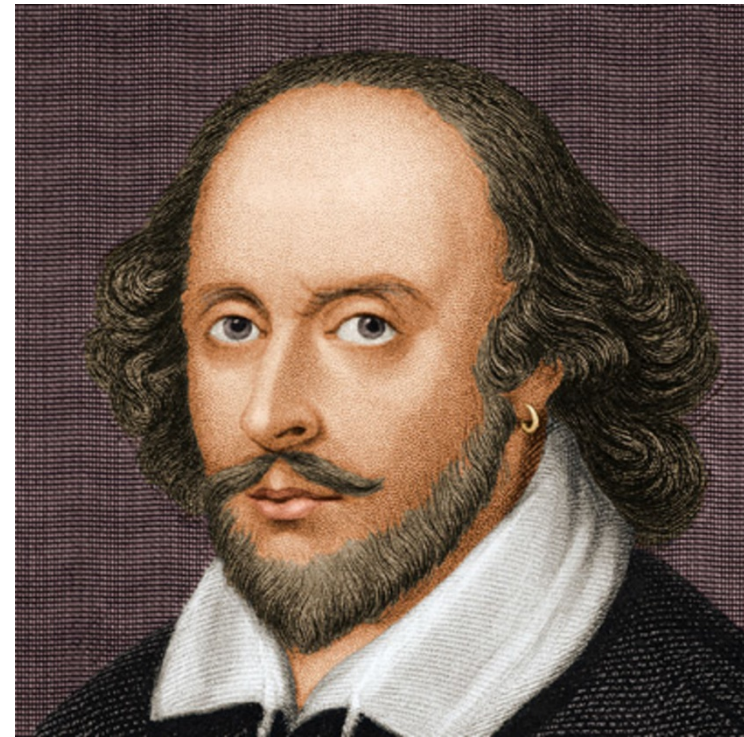
Toward Reasonable ODFI Due Diligence on Payday Lender Payment Processing

- Did the ODFI provide adequate scrutiny of merchants and/or third party payment processors when forming ACH processing relationships and in regularly monitoring those relationships?
- Did the ODFI adequately screen, monitor, and respond to return rates?
- Did the ODFI verify the lender has a valid small dollar lending license in the borrower's home state?
- Did the ODFI have an adequate compliance management system that periodically tested for compliance?
- Did the ODFI promptly terminate relationship with third party payment processors or merchants when appropriate?

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