More Regulation of Payday Type Loans on the Horizon - Will Impact Banks and Credit Unions

April 25, 2013 - The Consumer Financial Protection Bureau (CFPB) has release a white paper on the payday loan industry. But unlike most payday loan studies, the CFPB didn't just look at traditional payday lenders. Their paper included traditional banks and credit unions that offer products known as "deposit advance". According to the paper, these products function in a way that is substantially similar to payday loans, with exorbitant interest rates. Although it hasn't been said officially yet, there is little doubt that further regulation of all payday loan products is being considered.

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The CFPB paper stated that deposit advance products offered by traditional lenders typically generate $10 in interest for every $100 borrowed. But unlike regular loans which are often repaid over years, payday loans these loans are for a 12 day period. On an annualized basis, the interest being charged on deposit advance loans is over 300%.

As bad as those numbers are for consumers, they are still more attractive than those offered by traditional payday lenders. According the report, storefront payday lenders typically charge $15 interest on every $100 borrowed. That equates to a 394% annual interest rate.

The paper also determined that once a borrower uses a deposit advance loan, they are more prone to use them again in the future. More than half of all borrowers borrowed at least $3,000 over the course of the year, and more than 40% of these borrowers carried a balance for 9 months out of the year.

One of the more interesting things in the report was a portion that discussed bank overdraft fees. Many lenders that offer deposit advance loans are marketing them as a way to avoid overdraft fees. The study found that the heaviest deposit advance borrowers were actually the largest generators of over draft fees for the lenders. This means that in addition to fees being generated for overdrawing their accounts, these borrowers are also generating huge interest payments to lenders.

There is speculation that both the Office of the Comptroller of the Currency and the FDIC are considering tough new regulations on deposit advance products. These could take the form of interest caps but more likely would require lenders to change some of their marketing policies, forbid the refinancing or roll-over of any outstanding balances from previous deposit advance loans and require lenders to take into account the borrower's ability to repay the loan in full.

The paper looked at a sampling of 100,000 bank accounts. Of those, approximately 15% of the accounts used deposit advanced loans at least once during the study period.

byJim Malmberg
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