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Subject: Payday Lending by Credit Unions
**Division of Credit Unions Interpretive Letter I-05-06**

**Issues:**

1. What fees may a credit union charge for a payday loan?

2. Must a credit union be licensed as a payday lender to do unsecured, small loans that exceed the Washington State usury rate?

3. May a credit union make payday loans to non-members?

4. Is a license required when a credit union funds a loan, but a credit union service organization processes the loan and makes the loan approval decision?

## Background

A "payday loan" refers to a type of short-term, high fee, unsecured loan that is typically offered to consumers by a business outlet offering check cashing services. The business of check cashing and selling, as well as payday lending, is regulated by the Department of Financial Institutions (DFI) pursuant to the Check Cashers and Sellers Act (CCSA), Chapter 31.45 RCW.

Credit unions have a long history of making small-dollar, short-term, unsecured loans to their members. Recently, credit unions have become interested in offering their members payday loans as an alternative to traditional payday lenders. Payday loans are generally considered a type of sub-prime lending and require prudent risk-management.

In a typical payday loan transaction, the consumer writes the lender a post-dated check and, in return, the lender provides a lesser amount of cash to the consumer after subtracting fees. At the end of the loan period, the consumer has the option of either redeeming the check by paying its face value to the lender, or allowing the lender to cash the check. Most payday loans are for relatively short periods of time (from a week to a month).

Payday lenders licensed under the CCSA may loan a maximum of $700 at one time, for a maximum term of 45 days, and fees cannot exceed 15% of the principal for amounts up to $500, and 10% of the principal for the amount lent over $500. RCW 31.45.073. The annual percentage rate resulting from a typical 15-day loan is 391%. Washington State Department of Financial Institutions, *Payday Lending Report, Statistics and Trends for 2003*, pp. 2, 5.

**Analysis**

**1. What fees may a credit union charge for a payday loan?**

With a few exceptions, the maximum rate of interest that may be charged on a consumer loan under Washington's usury law is the greater of 12% per year or 4% above the first auction quote on the Federal Reserve's 26-week treasury bills made in the month before the loan was made. RCW 19.52.020(1).

However, Washington State-chartered credit unions also have the ability to charge higher rates of interest under the "most favored lender" doctrine, now codified in Washington statutes, which allows Washington financial institutions to charge interest rates equal to the rate national banks may charge a Washington consumer. RCW 30.04.025, RCW 30.22.040(12), 12 USC 85.

National banks in Oregon, Idaho, and 21 other jurisdictions have no ceiling on interest rates, and have the ability to export interest rates for multi-state operations. Because of the most favored lender doctrine, financial institutions can charge interest rates as high as the market will bear.

**2. Must a credit union be licensed as a payday lender to make small, unsecured loans that exceed the Washington State usury rate?**

The Check Cashers and Sellers Act (CCSA), Chapter 31.45 RCW, governs the regulation of payday lenders. Credit unions are exempt from the licensing requirements of the CCSA. RCW 31.45.010(11), RCW 31.45.020(1)(a). Therefore, a credit union does not have to be licensed in order to make small, unsecured loans that exceed the Washington State usury rate.

**3. Can a credit union make "payday loans" to non-members?**

A credit union may make unsecured loans only to its members. RCW 31.12.426, RCW 31.12.428, RCW 31.12.402. The Washington State Credit Union Act does not allow credit unions to offer loans to non-members.

4. **Is a license required when a credit union funds payday loans, but a credit union service organization (CUSO) processes the loans and makes loan approval decisions?**

Credit unions are exempt from the licensing requirements of the Check Cashers and Sellers Act. In this model, because the credit union is funding the loan, we have concluded that the credit union is doing the actual lending, and thus no license is required. RCW 31.45.010(11), RCW 31.45.020(1)(a).

## Conclusion

Washington State-chartered credit unions do not have to be licensed under the CCSA in order to offer payday loans to their members. In doing so, they may charge rates equal to those charged by national banks doing business in Washington. Even if a CUSO is processing the payday loans and making loan approval decisions, so long as the credit union itself is funding the loans, no license is required.

Payday lending can pose a variety of safety and soundness, compliance, fraud, and reputation risks to credit unions. Credit unions should be aware of the risks associated with payday lending, and should seek legal counsel before embarking on a payday lending program. The National Credit Union Administration (NCUA), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) have issued advisory guidelines for institutions considering engaging in payday lending. For further information, please see:

NCUA *Letter to Federal Credit Unions Number 01-FCU-03* at
http://www.ncua.gov/letters/2001/01-FCU-03.pdf;

OCC *Advisory Letter on Payday Lending, AL 2000-10* at
http://www.occ.treas.gov/efiles/disk1/advisory/2000-10.doc;

FDIC publications *Guidelines for Payday Lending* at
http://www.fdic.gov/regulations/safety/payday/;

*Advisory Committee on Banking Policy – Payday Lending* at
http://www.fdic.gov/about/learn/advisorycommittee/payday060204.html;

*An Update on Emerging Issues in Banking – Payday Lending* at
http://www.fdic.gov/bank/analytical/fyi/2003/012903fyi.html.