State of Washington

DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF CREDIT UNIONS

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Subject: Payday Lending by Credit Union Service Organizations (CUSOs)

Division of Credit Unions Interpretive Letter I-05-07

Issues

1. Must a CUSO be licensed to make unsecured, small loans that exceed the Washington State usury rate?

2. May a CUSO make payday loans to "non-members?"

3. May a licensed CUSO payday lender operate out of a credit union lobby?

4. If a licensed CUSO payday lender wants to originate payday loans at shared branching sites of the parent credit union, must each shared branching site be licensed?

5. May a licensed CUSO payday lender pay a fee to a credit union that cashes a payday loan check?

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.

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.

Note that the following analysis only applies to CUSOs with investments or loans from a Washington state-chartered credit union. A CUSO headquartered in Washington State with an investment or loan from any federally chartered credit union should refer to National Credit Union Administration (NCUA) guidelines.

Analysis

1. Must a CUSO be licensed to do unsecured, small loans that exceed the Washington State usury rate?

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).

One of the exceptions to the usury law is for small loans made by businesses regulated under the Check Cashers and Sellers Act (CCSA), Chapter 31.45 RCW. In order to avail itself of this exception; a business must obtain a license and a small loan endorsement. In addition to the loan amount, term, and fee limits mentioned above, payday lenders are subject to other requirements, outlined in Chapter 31.45 RCW and Chapter 208-630 of the Washington Administrative Code.

Financial institutions, including credit unions, are exempt from the CCSA. For a further discussion of a state chartered credit union's authority to make payday loans, see Interpretative Letter I-05-06. CUSOs are not exempt from the CCSA, and thus are subject to all of the licensing and other requirements of the CCSA.

2. May a CUSO make payday loans to "non-members?"

The Washington State Credit Union Act (Credit Union Act) defines a "credit union service organization" as an organization whose primary purpose is to strengthen, advance, or provide services to the credit union industry or credit union members. RCW 31.12.005(6), RCW 31.12.436(8). The Credit Union Act defines "primarily" as more than one half. RCW 31.12.005(20). Therefore, as long as a CUSO, whose purpose is to make payday loans, is making more than half of them to credit union members, then payday loans may also be made to non-members.

3. May a licensed CUSO payday lender operate out of a credit union lobby?

There is nothing in the Credit Union Act that prohibits a payday lender CUSO from operating out of a credit union lobby. There may be liability or other risks which the credit union should discuss with its legal counsel.

4. If a licensed CUSO payday lender wants to originate payday loans at shared branching sites of the parent credit union, must each shared branching site be licensed?

The CCSA requires a payday lender to have a check cashers and sellers license at its main location in order to do business. RCW 31.45.030(1). A payday lender must also have a small loan endorsement for each location where it makes small loans. RCW 31.45.070(1), RCW 31.45.073(1). Thus, each shared branching site where the CUSO is making payday loans must have a small loan endorsement, but is not required to be separately licensed.

5. May a licensed CUSO payday lender pay a fee to a credit union that cashes a payday loan check?

Washington State-chartered credit unions are granted certain incidental powers through the Washington State Credit Union Act and through the operation of federal parity. RCW 31.12.404. Incidental powers are those powers necessary or convenient to enable the credit union to conduct its business. RCW 31.12.402(23), 12 CFR 721. All of the incidental powers pre-approved in NCUA rules for federally chartered credit unions are also available to state-chartered credit unions. One of the pre-approved activities under NCUA rules is "finder activities," defined as introducing or bringing together outside vendors with credit union members for transactions. 12 CFR 721.3(f). A credit union cashing the payday loan checks of CUSO customers would fall within the definition of "finder activities."

If the CUSO is serving members and non-members, only members would be able to cash their payday loan checks in the credit union, as the credit union itself is limited to serving members, even though the CUSO can serve non-credit union members.

For a more thorough discussion of the incidental powers available to credit unions through state law or federal parity, and related safety and soundness considerations, please refer to DCU Opinion No. 01-8, published on November 8, 2001.

Conclusion

Unlike credit unions, CUSOs are required to be licensed and follow the provisions of the Check Cashers and Sellers Act and its companion regulations (Chapter 31.45 RCW and Chapter 208-630 WAC).

CUSOs may make loans to non-credit union members, so long as more than half of all loans are made to credit union members. Credit unions, through their incidental powers, have the ability to cash credit union member payday loan checks, but cannot cash non-member checks.

There is no law preventing CUSOs from operating out of credit union lobbies, but credit unions should be aware of liability and other risks. CUSOs may operate payday lending activities out of shared branching sites, so long as each site has a separate small loan endorsement.

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.