Analysis of FDIC's Revised Examination Guidance for Payday Lending Programs

March 14, 2005

On March 1, 2005, the FDIC announced revisions to its guidelines to banks engaged in payday lending. The guidelines seek to "ensure that this high-cost, short-term credit product is not provided repeatedly to customers with longer-term credit needs."[1] Thus, the FDIC has taken the important step of recognizing that payday lending can lead to a debt-trap.

The guidelines call on banks to develop procedures to ensure that they do not make payday loans to customers who have had payday loans outstanding from any lender for a total of more than three months in the previous 12 months. Assuming a typical payday loan of two weeks, the FDIC guidelines would permit six transactions, but then would require the bank to offer to or refer the borrower to a longer-term credit product.

The other provisions of the guidelines remain unchanged.

The Revised Examination Guidance is a positive step by the FDIC, however, the full impact of the Guidance is uncertain.

1. **The Guidance could significantly impact the economics of the current payday lending business model.** The debt trap is fundamental to the success of the payday lending business model. The Guidance, if effectively enforced, will substantially reduce the revenues that flow from abusive loan flipping, especially in states that do not authorize payday lending. Look for payday lenders to increase pressure on these states to enact safe-harbor legislation in order to protect their profits.

2. **The Guidance does not address the rent-a-bank problem**. The FDIC missed an opportunity to clarify that non-bank payday lenders are subject to state law regulation. Failure to make this clarification means states like Georgia and New York will continue to expend significant enforcement resources to combat payday lender assertions that federal law preempts state regulation of their activities.

3. **The effectiveness of the Guidelines is dependent on the FDIC's rigorous enforcement, as payday lenders will seek to evade the new restrictions**. In order to evade the three-month limit, payday lenders may suggest to customers that different members of the same household take out loans. It is unclear what the FDIC will require of these lenders to ensure compliance with the three-month limit, however the banks are required to submit compliance plans to the FDIC to reflect the new revisions. In addition, there are no specific recommendations as to what type of "longer-term credit product" would be an acceptable replacement for the payday loan product.

[1] Financial Institution Letter, FIL-14-2005, March 1, 2005.