

Death by a Thousand Cuts: Update on Small-Dollar Lending

By Catherine M. Brennan, Justin B. Hosie, K. Dailey Wilson, and Erica A.N. Kramer*

INTRODUCTION

During the past year, small-dollar lenders continued to face increasing legal and regulatory scrutiny at the state and federal level.¹ One large lender blamed increasing regulatory pressure as the leading reason for ceasing to offer payday and title loans.² This survey reviews some of the key investigation, enforcement, litigation, legislation, and rulemaking developments since August 2014.

FEDERAL ENFORCEMENT ACTIONS

PAYPAL, INC.

In May 2015, the Bureau of Consumer Financial Protection (“CFPB”) announced the settlement of its enforcement action against PayPal, Inc. and its financing subsidiary, Bill-Me-Later, Inc. (“PayPal”).³ In its complaint, the CFPB took direct aim at PayPal’s credit product, PayPal Credit, formerly known as Bill-Me-Later, which allows consumers to pay over time, for a fee, for online and in-store purchases.⁴ The CFPB’s claims focused on advertising, enrollment practices, payment processing, and payment allocation.⁵

The CFPB alleged that PayPal’s advertising was deceptive because PayPal repeatedly offered promotional credit or money back, but did not honor the

* Catherine M. Brennan and Justin B. Hosie are partners at Hudson Cook, LLP. K. Dailey Wilson and Erica A.N. Kramer are associates at Hudson Cook, LLP.

1. See Richard P. Eckman, Richard J. Zack, Christina O. Hud, Jonathan N. Ledsky & Scott J. Helfand, *Update on the Short-Term Lending Industry: Government Investigations and Enforcement Actions*, 70 BUS. LAW. 657 (2015).

2. See Adam Rust, *Fearing Regulatory Horizon EZCorp Says It Will Cease Consumer Lending*, BANK TALK (Aug. 4, 2015), <http://banktalk.org/content/fearing-regulatory-horizon-ezcorp-says-it-will-drop-payday-lending>.

3. Press Release, Consumer Fin. Prot. Bureau, CFPB Takes Action Against PayPal for Illegally Signing Up Consumers for Unwanted Online Credit (May 19, 2015), <http://www.consumerfinance.gov/newsroom/cfpb-takes-action-against-paypal-for-illegally-signing-up-consumers-for-unwanted-online-credit/>.

4. Complaint at 1, CFPB v. PayPal, Inc., No. 1:15-cv-01426 (D. Md. May 19, 2015), http://files.consumerfinance.gov/f/201505_cfpb_complaint-paypal.pdf.

5. *Id.*

offers.⁶ PayPal also allegedly enrolled some of its customers in PayPal Credit and its electronic billing method without their knowledge or consent, simply because those customers established a PayPal account.⁷ The CFPB asserted that this constituted an unfair practice because it caused substantial injury to consumers that they could not reasonably avoid.⁸ This injury included a credit report inquiry that impacted consumers' credit scores, as well as accrued interest and late fees for failing to pay an account they did not know existed.⁹

Additionally, PayPal allegedly caused consumers to pay for purchases with PayPal Credit even where they expressly sought to use a different payment method.¹⁰ Once a PayPal Credit account was established, it allegedly became the default payment method for all purchases, causing consumers to use the account even though they intended to use another payment method, such as a linked bank account.¹¹ The CFPB also asserted that PayPal abusively applied payment amounts in excess of the minimum payment to lower interest balances, leaving higher interest balances to continue to accrue higher interest.¹² The CFPB asserted that consumers could not clearly understand how PayPal Credit applied payments to deferred-interest promotions, and that it applied payments in a way that consumers would not have chosen.¹³

To settle the lawsuit, PayPal agreed to pay \$15 million to consumers who were mistakenly enrolled in PayPal Credit, who mistakenly paid for a purchase with PayPal Credit, or who incurred fees or deferred interest because of inadequate disclosures and flawed customer-service practices.¹⁴ PayPal also agreed to improve its consumer disclosures and to pay a \$10 million fine.¹⁵

OTHER FEDERAL ENFORCEMENT ACTIONS

In January 2015, the Federal Trade Commission ("FTC") announced enforcement actions against two title lenders, First American Title Lending of Georgia, LLC and Finance Select, Inc., based on allegedly deceptive advertising involving introductory offers of a zero percent rate used to market their title loans.¹⁶ In a decision in one of the enforcement actions, the FTC ordered the title lender to, among other things, not state an introductory or temporary finance charge with-

6. *Id.* at 2.

7. *Id.*

8. *Id.* at 11–13.

9. *Id.* at 13–14.

10. *Id.* at 15.

11. *Id.*

12. *Id.*

13. *Id.*

14. Stipulated Final Judgment at 8, CFPB v. PayPal, Inc., No. 1:15-cv-01426 (D. Md. May 21, 2015), http://files.consumerfinance.gov/f/201505_cfpb_consent-order-paypal.pdf.

15. *Id.* at 10.

16. Press Release, Fed. Trade Comm'n, In First FTC Cases Against Car Title Lenders, Companies Settle Charges They Deceptively Advertised the Cost of Their Loans (Jan. 30, 2015), <https://www.ftc.gov/news-events/press-releases/2015/01/first-ftc-cases-against-car-title-lenders-companies-settle>.

out clearly and conspicuously disclosing the finance charge after the introductory or temporary period ends.¹⁷

In February 2015, the FTC sued Payday Support Center, LLC, a debt relief services provider, and related parties (“PSC”) for deceptive practices in violation of the FTC Act and the Telemarketing Sales Rule.¹⁸ The FTC alleged that PSC falsely represented that it would pay off, restructure, or eliminate consumers’ payday loans.¹⁹ The FTC also asserted that PSC fraudulently represented that consumers’ creditors generally would cancel their payday loans after receiving a form letter requesting “validation” of the loans and that their payments to PSC would be applied to pay off their payday loans.²⁰ The FTC also alleged that PSC fraudulently claimed that its fee for services was only a small portion of the consumers’ program payments to PSC.²¹ As of this writing, the case was not resolved.

In July 2015, Adrian Rubin pleaded guilty to U.S. Department of Justice (“DOJ”) charges that he conspired to evade state usury laws and other restrictions on payday loans by engaging in deceptive business practices in violation of the Racketeer Influenced and Corrupt Organizations Act (“RICO”).²² In its press release announcing the charges, the DOJ claimed that Rubin violated RICO and federal laws banning mail and wire fraud by paying a federally insured bank, which was not subject to state laws, “to pretend that it was the payday lender.”²³ The DOJ also claimed that Rubin paid “an Indian tribe to pretend” that it was the actual payday lender as part of a scheme to have the tribe claim that “sovereign immunity” prevented application of state usury laws and other regulations.²⁴

STATE ENFORCEMENT ACTIONS AND INVESTIGATIONS

In March 2015, the New York State Department of Financial Services (“NYDFS”) entered into a consent order with Selling Source, LLC, a payday loan lead generation business, and other defendants (“Selling Source”).²⁵ Selling

17. *In re* First Am. Title Lending Co. of Ga., LLC, No. C-4529, slip op. at 3 (F.T.C. June 2, 2015), <https://www.ftc.gov/system/files/documents/cases/1506firstamericando.pdf>; *In re* Fin. Select Inc. of Ga., No. C-4528, slip op. at 3 (F.T.C. June 2, 2015), <https://www.ftc.gov/system/files/documents/cases/1506fastcashdo.pdf>.

18. Complaint at 1–2, *FTC v. PSC Admin., LLC*, No. 1:15-cv-00084 (S.D. Ala. Feb. 18, 2015), <https://www.ftc.gov/system/files/documents/cases/150224paydaycmpt.pdf>.

19. *Id.* at 11.

20. *Id.*

21. *Id.* at 12.

22. See Press Release, U.S. Dep’t of Justice, RICO Conspiracy Charged in Payday Lending Case (June 22, 2015), <http://www.justice.gov/usao-edpa/pr/rico-conspiracy-charged-payday-lending-case> [hereinafter Rubin Press Release]; see also Information, *United States v. Rubin*, No. 2:15-cr-00238-ER (E.D. Pa. June 9, 2015), <http://www.justice.gov/usao-edpa/file/479826/download>.

23. Rubin Press Release, *supra* note 22.

24. *Id.*

25. Consent Order *In re* Selling Source, LLC (N.Y. Dep’t of Fin. Servs. Mar. 9, 2015), <http://www.dfs.ny.gov/about/ea/ea150310.pdf> [hereinafter Selling Source Consent Order]; see Press Release, N.Y. Dep’t of Fin. Servs., NYDFS Announces MoneyMutual Will Pay \$2.1 Million Penalty; Montel

Source used celebrity Montel Williams to generate leads for payday loans and allegedly represented to consumers that Montel Williams would not have endorsed Selling Source “if it were not a legitimate company.”²⁶

According to the consent order, Selling Source violated New York law by advertising loans to New York consumers that exceeded the 16 percent cap on interest for unlicensed non-bank lenders.²⁷ NYDFS also took note of Selling Source’s targeting of consumers for loan rollovers.²⁸ To settle the enforcement action, Selling Source agreed to pay a \$2.1 million civil penalty.²⁹ Selling Source also agreed to withdraw from the New York market and to place a clear and conspicuous statement on its websites indicating that payday loan referrals are “not available in New York or to New York borrowers due to interest rate limits under New York law.”³⁰

In March 2015, the Virginia Attorney General launched a comprehensive effort targeted at predatory lending.³¹ In July 2015, he filed a lawsuit against B&B Pawnbrokers, Inc. for allegedly “making illegal, unlicensed motor vehicle title loans, and for charging excessive fees.”³² The complaint sought restitution on behalf of consumers, civil penalties, attorney’s fees, and injunctive relief.³³

The Connecticut Department of Banking pursued action against a group of online lenders organized under the laws of the Otoe-Missouria Tribe of Indians,³⁴ alleging that they made usurious and unlicensed loans.³⁵ The lenders allegedly solicited business from Connecticut residents via mail, e-mail, and its website.³⁶ The Department issued an administrative cease-and-desist order and ordered the defendants to pay civil penalties and restitution.³⁷ After failing to obtain dismissal of the order, the defendants appealed the decision to Connecticut state court.³⁸

Williams to Withdraw Endorsement for New York Payday Loans (Mar. 10, 2015), <http://www.dfs.ny.gov/about/press/pr1503101.htm>.

26. Selling Source Consent Order, *supra* note 25, at 6.

27. *Id.* at 5.

28. *Id.* at 7.

29. *Id.* at 8.

30. *Id.* at 11.

31. See Press Release, Va. Attorney Gen., Attorney General Herring Launching Effort to Combat Predatory Lending (Mar. 26, 2015), <http://www.oag.state.va.us/index.php/en/media-center/news-releases/480-march-26-2015-herring-launching-effort-to-combat-predatory-lending?highlight=WyjsZW5kaW5nIl0=>.

32. See Press Release, Va. Attorney Gen., Attorney General Herring Sues Fredericksburg Pawnshop for Illegal Loans (July 21, 2015), <http://www.oag.state.va.us/index.php/media-center/news-releases/586-july-21-2015-attorney-general-herring-sues-fredericksburg-pawnshop-for-illegal-loans>.

33. See Complaint, Virginia *ex rel.* Herring v. B&B Pawnbrokers, Inc., No. CL15003155-00 (Richmond City Cir. Ct. July 21, 2015), http://ag.virginia.gov/files/BB_Pawnbrokers-Complaint.pdf.

34. Complaint, *In re* Great Plains Lending, LLC (Conn. Dep’t of Banking Oct. 24, 2014), <http://www.ct.gov/dob/cwp/view.asp?a=2246&q=555898>.

35. *Id.*

36. *Id.*

37. *Id.*; see Mark Paznoikas, *Tribal Lenders Claim Right to Charge 448% on Loans in CT*, CONN. MIRROR (Apr. 3, 2015), <http://ctmirror.org/2015/04/03/oklahoma-tribal-lenders-defy-ct-charge-448-on-loans>.

38. See Plaintiffs’ Brief at 1, *Great Plains Lending, LLC v. Conn. Dep’t of Banking*, No. HHB-CV15-6028096-S (New Britain Super. Ct. Aug. 10, 2015), <https://turtletalk.files.wordpress.com/2015/09/great-plains-brief.pdf>.

In November 2014, the Pennsylvania Attorney General issued a press release announcing a consumer protection lawsuit against several Texas-based corporations, alleging that they used an Indian tribe as a cover to provide payday loans, which are illegal in Pennsylvania.³⁹ The lawsuit sought injunctive relief, restitution, civil penalties, and removal of negative credit reporting information from affected consumers' credit reports.⁴⁰

STATE LEGISLATION

Several states enacted legislation during the past year that made significant changes to the laws that regulate small-dollar lending. Georgia House Bill 299, effective May 6, 2015, applies to: loans made pursuant to the Georgia Industrial Loan Act, retail installment and home solicitation sales under the Retail Installment and Home Solicitation Sales Act, motor vehicle sales financing contracts entered into pursuant to the Motor Vehicle Sales Finance Act, and insurance premium finance agreements.⁴¹ The law permits a lender or merchant to collect a nonrefundable convenience fee from any person who chooses to pay electronically.⁴² The convenience fee must be in an amount equal to the actual cost borne by the lender or merchant.⁴³ However, the law permits an alternative, under which a lender or merchant may impose a convenience fee that does not exceed the average cost of the electronic payment method.⁴⁴ Convenience fees are prohibited unless a lender or merchant also provides a direct payment option by check, cash, or money order.⁴⁵ A convenience fee cannot be imposed for the direct payment method.⁴⁶ The new law also imposes notice requirements regarding convenience fees.⁴⁷

Indiana House Bill 1287 revises, effective July 1, 2015, the Indiana Code to require that all those regularly engaging in making small loans to have a small loan license.⁴⁸ The newly revised statutory provision prohibits any person from "regularly engaging" in making small loans, taking assignment of small loans, or "undertaking the direct collection of payments from or the enforcement of rights against debtors arising from small loans" without a license⁴⁹ Those

39. Press Release, Pa. Attorney Gen., Attorney General Kane Files Lawsuit over Alleged Illegal Payday Loan Scheme (Nov. 13, 2014), https://www.attorneygeneral.gov/Media_and_Resources/Press_Releases/Press_Release/?pid=1205.

40. *Id.*

41. See GA. CODE ANN. § 13-1-15(e) (West, Westlaw current through end of 2015 Reg. Sess.).

42. *Id.* § 13-1-15.

43. *Id.* § 13-1-15(a)(1).

44. *Id.* § 13-1-15(a)(2), (b).

45. *Id.* § 13-1-15(c).

46. *Id.*

47. *Id.* § 13-1-15(d).

48. IND. CODE ANN. § 24-4.5-7-102 (West, Westlaw current through end of 2015 1st Reg. Sess.). A person "regularly engages" in making small loans, taking assignment of small loans, or undertaking the direct collection of payments of small loans if he or she either (a) performs any of the aforementioned activities one time in the previous calendar year or (b) performs or will perform any of the aforementioned activities one time in the current calendar year. *Id.* § 24-4.5-7-102(7).

49. *Id.* § 24-4.5-7-102(2).

engaging in these activities as both small loan lenders and consumer lenders in Indiana must obtain both the small loan license and the consumer loan license—merely holding the consumer loan license will not be sufficient.⁵⁰ Similar prohibitions on making small-dollar loans were enacted in Connecticut and Oregon.⁵¹ The new Indiana law also prohibits lenders from imposing payment plan terms that would require payments before the original maturity date of the outstanding small loan.⁵² In addition, if a borrower is eligible for a payment plan and has not entered into one, then the new limitations prohibit lenders from entering into a new small loan with the borrower.⁵³ Nevada Senate Bill 242, the Payday Lender Best Practices Act, effective October 1, 2015,⁵⁴ requires licensees under the deferred deposit, high interest, and title loan provisions to adhere to eleven so-called best practices.⁵⁵ Those practices include disclosure requirements,⁵⁶ procedural requirements,⁵⁷ and advertising notice requirements.⁵⁸ The law also sets forth several other provisions that mimic already existing requirements under Nevada law.⁵⁹

Through House Bill 644, effective January 1, 2016,⁶⁰ New Hampshire completely overhauled its statute that regulates small loans, payday loans, and title loans.⁶¹ For example, the phrase “small loan” was revised to mean any title loan, payday loan, open-end loan, or closed-end loan that is \$10,000 or less with an annual percentage rate of 10 percent or more.⁶² Certain fees are exempted from interest under this definition of a small loan, including fees paid to a public official for filing or recording and the reasonable costs and fees associated with the repossession and sale of a security.⁶³

South Dakota House Bill 1027, effective July 1, 2015,⁶⁴ revised the South Dakota Money Lending Licenses Act in several respects, including explicitly defining the term “business of lending money.”⁶⁵ Under existing South Dakota law,

50. *Id.* § 24-4.5-7-102(4).

51. See CONN. GEN. STAT. ANN. § 36a-573 (West, Westlaw current through end of 2015 Reg. Sess. and June Special Sess.) (revising the statute to provide that any interest or charges received in excess of that provided in the small loan provisions would render the loan void); OR. REV. STAT. ANN. § 725.045 (West, Westlaw current with 2015 Reg. Sess. legis. eff. through Oct. 5, 2015) (providing that any consumer finance loans of \$50,000 or less made without a license are null and void).

52. IND. CODE ANN. § 24-4.5-7-401(3)(g) (West, Westlaw current through end of 2015 1st Reg. Sess.).

53. *Id.* § 24-4.5-7-401(3)(g).

54. S. 242, 78th Leg. Sess. (Nev. 2015).

55. *Id.*

56. *Id.* § 4.

57. *Id.* § 7.

58. *Id.*

59. *Id.* §§ 8–10.

60. H.R. 644, 2015 Sess. (N.H. 2015), http://www.gencourt.state.nh.us/bill_status/bill_docket.aspx?sr=715&sy=2015&sortoption=&txtsessionyear=2015&txtbillnumber=hb644.

61. N.H. REV. STAT. ANN. §§ 399-A:1 to A:20 (West, Westlaw current through Chapter 275 (End) of the 2015 Reg. Sess.).

62. *Id.* § 399-A:1(XX).

63. *Id.*

64. See 2015 S.D. Sess. Laws ch. 242, § 1.

65. S.D. CODIFIED LAWS § 54-4-40 (West, Westlaw current through end of 2015 Reg. Sess., Exec. Order 15-1, Sup. Ct. R. 15-16).

any person that engages in the business of lending money is required to have a money lender's license.⁶⁶ The term business of lending money now includes "originating, selling, servicing, acquiring, or purchasing loans, or servicing, acquiring, or purchasing retail installment contracts."⁶⁷

CFPB PROPOSAL FOR SMALL-DOLLAR LENDING RULEMAKING

Pursuant to the consultation process required by the Small Business Regulatory Enforcement Fairness Act,⁶⁸ the CFPB announced in March 2015 that it is considering proposing rules covering several types of small-dollar lending: payday loans; deposit advance products; vehicle title loans; installment loans with an "all-in" annual percentage rate above 36 percent per year involving either an account access device, e.g., checks, automated clearinghouse authorizations, or a vehicle title as security; and open-end lines of credit.⁶⁹ The proposal does not cover non-recourse pawn transactions involving taking possession of the pawned item, rather than taking possession of the title.⁷⁰ The proposal also excludes credit card accounts, real estate secured loans, student loans, and deposit account overdraft services.⁷¹

The proposal under consideration includes prevention and protection requirements.⁷² Under the prevention requirements, consumers would be required to prove an ability to repay before entering a covered transaction.⁷³ Under the protection requirements, various restrictions would limit the specific terms of transactions without an ability-to-repay requirement.⁷⁴

The proposal will also delineate between short-term credit and long-term credit.⁷⁵ Short-term credit covered by the proposal will involve transactions with a term of forty-five days or less, and such transactions would be governed by either an ability-to-repay requirement or an alternative set of requirements.⁷⁶ Long-term credit transactions are those with terms over forty-five days involving an all-in annual percentage rate⁷⁷ above 36 percent that include either an

66. *Id.*

67. *Id.* § 54-4-36(1).

68. See 5 U.S.C. § 609 (2012).

69. CONSUMER FIN. PROT. BUREAU, SMALL BUSINESS ADVISORY REVIEW PANEL FOR POTENTIAL RULEMAKINGS FOR PAYDAY, VEHICLE TITLE, AND SIMILAR LOANS: OUTLINE OF PROPOSALS UNDER CONSIDERATION AND ALTERNATIVES CONSIDERED (Mar. 26, 2015) [hereinafter CFPB OUTLINE], http://files.consumerfinance.gov/f/201503_cfpb_outline-of-the-proposals-from-small-business-review-panel.pdf.

70. *Id.* at 7.

71. *Id.*

72. Consumer Fin. Prot. Bureau, Factsheet: The CFPB Considers Proposal to End Payday Debt Traps 1 (Mar. 26, 2015), http://files.consumerfinance.gov/f/201503_cfpb-proposal-under-consideration.pdf.

73. See CFPB OUTLINE, *supra* note 69, at 11–13, 22–23.

74. *Id.* at 16, 26–27.

75. *Id.* at 7, 19.

76. *Id.* at 7.

77. The CFPB Outline states that the CFPB is "considering using an annualized cost of credit measure that would include interest, fees, and the cost of ancillary products such as credit insurance, memberships, and other products sold along with the credit. One possible measure is the military annual percentage rate defined in 32 CFR 232." *Id.* at 7 n.10.

account access device or a vehicle title as security.⁷⁸ Like the short-term transactions, long-term transactions would be governed by either an ability-to-repay requirement or an alternative set of requirements.⁷⁹ The proposals under consideration would also impose collection, recordkeeping, and procedural requirements on all credit types.⁸⁰

The proposal states that the CFPB believes that these restrictions would lead to a substantial reduction in the volume of covered loans and fees generated.⁸¹ Noting “a number of sources of uncertainty”⁸² and that its figures “should not be taken as lower or upper bounds on the impact”⁸³ of the proposal, the CFPB nonetheless predicted that storefront short-term payday loan volume would fall by 69 percent to 84 percent.⁸⁴ No similar prediction was made for short-term title loan volume or for installment lending volume.

78. *Id.* at 19–20.

79. *Id.*

80. *Id.* at 28–31.

81. *Id.* at 40.

82. *Id.* at 41.

83. *Id.* at 43.

84. *Id.*