Payday Lenders- Great Banking Partners or Banking Liability?
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According to an article by nbcnews.com, “There are more payday lenders in the U.S. than McDonald's or Starbucks….”[1] As payday lenders grow in number, so do their critics. To many, the payday lending industry means over-priced and un-regulated loans; however, that is hardly the case. Often times, Banking Financial Institutions (BFI) have the biggest misconception of payday lenders, in thinking that they are predatory and take advantage of their customers. This mistaken belief can lead to banks considering payday lenders as a liability rather than a potentially valued client.

Education based on objective data and factual analysis is the key for a BFI understanding the reasons why payday lenders make great banking partners, not banking liabilities, as appears to be the pervasive belief. Before they make such determination, BFIs should strive to have accurate understandings as to what a payday loan actually is and, perhaps more importantly, what it is not. So, what is a payday loan? The Consumer Financial Protection Bureau (“CFPB”) defines a payday loan or “cash advance” as a short-term loan, generally for $500 or less, that is typically due on the borrower’s next payday.[2]

Payday lenders are often classified as Non-Banking Financial Institutions (NBFI) or Non-Depository Financial Institutions (NDFI). The reason for such designations is that payday lenders offer consumer financial services, but do not hold a banking license. These institutions are not allowed to take deposits from the public and are not regulated by a federal banking regulatory agency such as the Federal Deposit Insurance Corporation (FDIC) or the Office of the Comptroller of the Currency (OCC).

Are payday lender’s considered Money Services Businesses (MSBs) by definition? Well, that depends on the circumstances. On February 25, 2002, FinCEN issued ruling *2002-2 Definition of Check-Casher (payday lender)*: explaining that in certain circumstances payday lenders are considered “check-cashers”; therefore, they must comply with the regulations that are applicable to MSBs. The ruling referenced above explains that a payday lender that deposits or negotiates a check in an amount that exceeds $1,000 per person per day, is considered a check casher under the Bank Secrecy Act (BSA).

Payday lenders routinely exceed regulatory requirements and offer additional consumer-friendly protections to those provided by law. Some ways that payday lenders achieve these additional protections are by:

- Creating a risk assessment, and
- Establishing Know Your Customer (KYC) Program

Risk Assessment-

[1] http://www.nbcnews.com/business/economy/there-are-more-payday -lenders-u-s-mcdonalds-n255156
[2] http://www.consumerfinance.gov/

Regulations do not require payday lenders or MSBs to have a risk assessment program. So, why would payday lenders take the time and expense to establish one? Risk assessments provide a clear view as to the organization's policies and procedures. The risk assessment identifies areas of high risk. These efforts allow the organization to establish a comprehensive Anti-Money Laundering (AML) Compliance Program that takes into consideration high risk areas.

Know Your Customer (KYC)-

"KYC" is a term with which banks are very familiar with but how do payday lenders compare? While some payday lenders may not be familiar with KYC requirements, they are quite familiar with the concept of Knowing Your Customer. Actually, even though payday lenders are not required to have formal KYC policies and procedures, such policies are nevertheless an area of focus in which they often perform well. The payday lending industry thrives on knowing their customer base and those customers' needs. The most basic concept of KYC is customer identification, which can be handled in many different ways. But, are there other ways to "Know Your Customer"? The list below includes policies that aide a payday lender in knowing its customers:

- Encourage employees to know what is normal for their customers;
- Ask customers about the purpose of the transaction;
- Have a clear understanding as to the products and services that the customer uses or may have a need for; or
- Ensure your customers are using the products and services for legitimate transactions.

By having a basic KYC program in place, organizations may be able to mitigate the risk of being used by criminals for money laundering activities. Such procedures will, in turn, mitigate the bank's risk in having payday lenders as banking partners.

Payday loans are also highly regulated. Payday lenders must comply with a variety of laws and regulations including, but not limited to: state regulations, Consumer Financial Protection Bureau (CFPB) regulations, Regulation B, Regulation Z/Truth-in-Lending (TILA) Regulations, Bank Secrecy Act (BSA), and Office of Foreign Assets Control (OFAC).

State laws often govern aspects of a payday loan such as requiring centralized database(s) for consumer transaction monitoring, maximum fee caps, and minimum and maximum term length for the transactions. With so many state level requirements, in addition to federal law requirements, for payday lenders, compliance can be a daunting task.

What most people fail to understand about payday lenders is that the industry is hardly "unregulated". In fact, the payday lending industry is among the most regulated financial industries in the country, because there are numerous state and federal regulations and statutes, often containing many variances, that must be complied with.

As bank partners receive enhanced due diligence from their regulators, payday lenders are often left under-banked or un-banked.

Payday lenders should consider taking the following steps to reassure banks that they are a great banking partner:

- Create and keep currant AML and OFAC Risk Assessment
- Develop and maintain a risk based AML Compliance Program
- Develop and maintain a risk based strong KYC Program
- Develop and maintain supplemental policy and procedures
- Implement a risk based OFAC policy
- Abide by industry best practices

It is vital for payday lenders to strive to meet all regulatory requirements as well as implement industry best practices. By having such high standards for compliance, this only validates payday Lenders as an asset with which banking institutions should be proud to partner.