US regulatory efforts to target the online lending industry

US regulators have attempted for years to end the online lending industry. The Department of Justice and the Federal Deposit Insurance Corp. have started to apply unprecedented pressure on financial institutions and payment processors to cease lawful consumer-authorised transactions.

Relying upon the Financial Institutions Reform, Recovery and Enforcement Act, the DoJ issued subpoenas that seek evidence to support the theory that any lender that is not licensed in the state of the consumer's residence is engaging in an illegal, usurious loan - and therefore a fraudulent transaction.

The DoJ and FDIC have represented that the overriding regulatory policy is to prevent an array of fraudulent business practices. However, such a policy would be less apt to damage lawful business operations if it were more narrowly tailored to actually meet the purported objective. Many believe that recent regulatory actions are overbroad and are merely an attempt to intimidate financial institutions by running an end-around the judicial and legislative processes.

Unmistakable is the fact that reputable online lenders that utilise lawful, licensed and non-abusive payment practices are being precluded from debiting consumer bank accounts. Despite the fact that in the last quarter of 2012 over 500,000 New Yorkers searched for short-term loans online, New York state regulators have gotten in on the act. On 6 August, the New York Department of Financial Services announced that it had issued cease and desist letters to 35 companies allegedly offering 'illegal' online small dollar loans. As part of this effort the DFS also sent letters to 117 banks as well as NACHA requesting that NACHA 'cut off access' to customer accounts.

In response, NACHA sent a letter to its Originating Depository Financial Institutions on 8 August, reminding them of their existing due diligence responsibilities to validate representations and warranties they make that every ACH debit has been properly authorised.

Seemingly, banks are also being incentivised to discriminate against Native American tribal lenders. Many unlicensed online lenders claim sovereign immunity due to their ties to Indian tribes and two tribes have stated in a federal lawsuit that their businesses' access to the payments system has dwindled because of New York's 'coercion.' Of the lenders that New York officials have targeted, some have notices on their websites that they are temporarily/permanently halting their lending operations. Others no longer have operational websites at all.

Have regulators failed to consider the impact of attempts to stifle legitimate business operations via the imposition of a heightened level of scrutiny into banking operations? It certainly appears so.

Shutting down an entire industry would be nothing more than a pyrrhic victory. Over regulation threatens the concept of consumer choice. The online lending industry has seen a significant increase in demand since the housing collapse in 2008 when other credit options were reduced.

Oftentimes consumers only need a few hundred dollars to avoid bank non-sufficient funds fees, a utility reconnection charge or a late payment fee. The fact remains that an online short-term loan can be less expensive than the alternatives.

Now more than ever regulators must take care not to harm the very consumers that they purport to protect. What is required is uniform federal regulation that provides convenient credit choices to consumers nationwide that may not be available in their home state, as well as certainty for lenders who provide small dollar high-risk loans.

Congress previously had the opportunity to prohibit online small dollar loans but instead acknowledged the need and legitimacy of them by giving the Consumer Financial Protection Bureau the power to supervise the industry and forbidding it from capping usury rates. The FDIC should be held accountable and asked to provide a transparent explanation of their small dollar loan policies, not the least of which being why examiners are putting pressure on banks to cease doing business with legal online small dollar lenders while, at the same time, encouraging its own supervised entities to provide similar credit products.

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