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Major Banks Aid in Payday Loans Banned by States

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Major banks have quickly become behind-the-scenes allies of Internet-based payday lenders that offer short-term loans with interest rates sometimes exceeding 500 percent.

With 15 states banning payday loans, a growing number of the lenders have set up online operations in more hospitable states or far-flung locales like Belize, Malta and the West Indies to more easily evade statewide caps on interest rates.

While the banks, which include giants like JPMorgan Chase, Bank of America and Wells Fargo, do not make the loans, they are a critical link for the lenders, enabling the lenders to withdraw payments automatically from borrowers' bank accounts, even in states where the loans are banned entirely. In some cases, the banks allow lenders to tap checking accounts even after the customers have begged them to stop the withdrawals.

"Without the assistance of the banks in processing and sending electronic funds, these lenders simply couldn't operate," said Josh Zinner, co-director of the Neighborhood Economic Development Advocacy Project, which works with community groups in New York.

The banking industry says it is simply serving customers who have authorized the lenders to withdraw money from their accounts. "The industry is not in a position to monitor customer accounts to see where their payments are going," said Virginia O'Neill, senior counsel with the American Bankers Association.

But state and federal officials are taking aim at the banks' role at a time when authorities are increasing their efforts to clamp down on payday lending and its practice of providing quick money to borrowers who need cash.

The Federal Deposit Insurance Corporation and the Consumer Financial Protection Bureau are examining banks' roles in the online loans, according to several people with direct knowledge of the matter. Benjamin M. Lawsky, who heads New York State's Department of Financial Services, is investigating how banks enable the online lenders to skirt New York law and make loans to residents of the state, where interest rates are capped at 25 percent.

For the banks, it can be a lucrative partnership. At first blush, processing automatic withdrawals hardly seems like a source of profit. But many customers are already on shaky financial footing. The withdrawals often set off a cascade of fees from problems like overdrafts. Roughly 27 percent of payday loan borrowers say that the loans caused them to overdraw their accounts, according to a report released this month by the Pew Charitable Trusts. That fee income is coveted, given that financial regulations limiting fees on debit and credit cards have cost banks billions of dollars.

Some state and federal authorities say the banks' role in enabling the lenders has frustrated government efforts to shield people from predatory loans — an issue that gained urgency after reckless mortgage lending helped precipitate the 2008 financial crisis.

Lawmakers, led by Senator Jeff Merkley, Democrat of Oregon, introduced a bill in July aimed at reining in the lenders, in part, by forcing them to abide by the laws of the state where the borrower lives, rather than where the lender is. The legislation, pending in Congress, would also allow borrowers to cancel automatic withdrawals more easily. "Technology has taken a lot of these scams online, and it's time to crack down," Mr. Merkley said in a statement when the bill was introduced.

While the loans are simple to obtain — some online lenders promise approval in minutes with no credit check — they are tough to get rid of. Customers who want to repay their loan in full typically must contact the online lender at least three days before the next withdrawal. Otherwise, the lender automatically renews the loans at least monthly and withdraws only the interest owed. Under federal law, customers are allowed to stop authorized withdrawals from their account. Still, some borrowers say their banks do not heed requests to stop the loans.

Ivy Brodsky, 37, thought she had figured out a way to stop six payday lenders from taking money from her account when she visited her Chase branch in Brighton Beach in Brooklyn in March to close it. But Chase kept the account open and between April and May, the six Internet lenders tried to withdraw money from Ms. Brodsky's account 55 times, according to bank records reviewed by The New York Times. Chase charged her $1,523 in fees — a combination of 44 insufficient fund fees, extended overdraft fees and service fees.

For Subrina Baptiste, 33, an educational assistant in Brooklyn, the overdraft fees levied by Chase cannibalized her child support income. She said she applied for a $400 loan from Loanshoponline.com and a $700 loan from Advancemetoday.com in 2011. The loans, with annual interest rates of 730 percent and 584 percent respectively, skirt New York law.

Ms. Baptiste said she asked Chase to revoke the automatic withdrawals in October 2011, but was told that she had to ask the lenders instead. In one month, her bank records show, the lenders tried to take money from her account at least six times. Chase charged her $812 in fees and deducted over $600 from her child-support payments to cover them.

"I don't understand why my own bank just wouldn't listen to me," Ms. Baptiste said, adding that Chase ultimately closed her account last January, three months after she asked.

A spokeswoman for Bank of America said the bank always honored requests to stop automatic withdrawals. Wells Fargo declined to comment. Kristin Lemkau, a spokeswoman for Chase, said: "We are working with the customers to resolve these cases." Online lenders say they work to abide by state laws.

Payday lenders have been dogged by controversy almost from their inception two decades ago from storefront check-cashing stores. In 2007, federal lawmakers restricted the lenders from focusing on military members. Across the country, states have steadily imposed caps on interest rates and fees that effectively ban the high-rate loans.

While there are no exact measures of how many lenders have migrated online, roughly three million Americans obtained an Internet payday loan in 2010, according to a July report by the Pew Charitable Trusts. By 2016, Internet loans will make up roughly 60 percent of the total payday loans, up from about 35 percent in 2011, according to John Hecht, an analyst with the investment bank Stephens Inc. As of 2011, he said, the volume of online payday loans was $13 billion, up more than 120 percent from $5.8 billion in 2006.

Facing increasingly inhospitable states, the lenders have also set up shop offshore. A former used-car dealership owner, who runs a series of online lenders through a shell corporation in Grenada, outlined the benefits of operating remotely in a 2005 deposition. Put simply, it was “lawsuit protection and tax reduction,” he said. Other lenders are based in Belize, Malta, the Isle of Man and the West Indies, according to federal court records.

At an industry conference last year, payday lenders discussed the benefits of heading offshore. Jer Ayler, president of the payday loan consultant Trihouse Inc., pinpointed Cancún, the Bahamas and Costa Rica as particularly fertile locales.

State prosecutors have been battling to keep online lenders from illegally making loans to residents where the loans are restricted. In December, Lori Swanson, Minnesota’s attorney general, settled with Sure Advance L.L.C. over claims that the online lender was operating without a license to make loans with interest rates of up to 1,564 percent. In Illinois, Attorney General Lisa Madigan is investigating a number of online lenders.

Arkansas’s attorney general, Dustin McDaniel, has been targeting lenders illegally making loans in his state, and says the Internet firms are tough to fight. “The Internet knows no borders,” he said. “There are layer upon layer of cyber-entities and some are difficult to trace.”

Last January, he sued the operator of a number of online lenders, claiming that the firms were breaking state law in Arkansas, which caps annual interest rates on loans at 17 percent.

Now the Online Lenders Alliance, a trade group, is backing legislation that would grant a federal charter for payday lenders. In supporting the bill, Lisa McGreevy, the group's chief executive, said: "A federal charter, as opposed to the current conflicting state regulatory schemes, will establish one clear set of rules for lenders to follow."