

New York DFS and Other Regulators Launch Investigation into Payroll Advance Industry

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On August 6, 2019, the New York Department of Financial Services Superintendent Linda A. Lacewell announced that the DFS will lead a multistate investigation into the payroll advance industry and allegations of unlawful online lending. The investigation focuses on whether companies are in violation of state banking laws, including usury limits, licensing laws and other applicable laws regulating payday lending and consumer protection laws. The following regulators will join the DFS in investigating the payroll advance industry:

- The Connecticut Department of Banking; Illinois Department of Financial Professional Regulation;
- The Office of the Commissioner for Financial Regulation in the State of Maryland;
- The New Jersey Department of Banking and Insurance;
- The North Carolina Office of the Commissioner of Banks;
- The North Dakota Department of Financial Institutions;
- The Oklahoma Department of Consumer Credit;
- The Puerto Rico Comisionado de Instituciones Financieras;
- The South Carolina Department of Consumer Affairs;
- The South Dakota Department of Labor and Regulation's Division of Banking; and
- The Texas Office of Consumer Credit Commissioner.

Payroll advance companies provide workers with an advance of earned income before workers would receive the money under their employer's payroll schedule. With the worker's authorization, the payroll advance company then deducts the advance amount from the worker's upcoming paycheck. While payroll advance companies generally do not expressly impose interest on these transactions, they are compensated for their services. The payroll advance company may charge a worker a monthly membership fee for payroll advance services or may impose fees on individual transactions. Payroll advance companies also may invite, but not require, workers to pay a "tip" to the company providing the service. In a DFS press release, Lacewell expressed concern about payroll advance companies

engaging in these practices, stating that "some of these firms appear to collect usurious or otherwise unlawful interest rates in the guise of 'tips,' monthly membership and/or exorbitant additional fees, and may force improper overdraft charges on vulnerable low-income consumers."

Proponents of the payroll advance industry take the position that the transactions do not constitute credit because the money advanced has already been earned by the worker and no interest is expressly imposed on the worker. Perhaps most crucially, the transactions are often non-recourse; there are no remedies if the worker fails to repay the advanced amount. In the context of other alternative financial products, such as litigation funding and merchant cash advances, courts have often held that a non-contingent obligation to repay is an essential element of a loan, and a transaction without this feature will not be recharacterized as a loan.

There is a potential for abuse with any consumer financial product. However, advances of earned income can be invaluable to many Americans, especially lower income individuals in the modern "gig economy." A growing number of employers have acknowledged this reality and now work with payroll advance companies to allow their employees greater flexibility in when they receive earned income. The growing popularity of payroll advance programs means that regulatory scrutiny is inevitable. It will be interesting to see how broadly regulators interpret their credit laws in determining whether these laws apply to payroll advance products. Carefully drafting payroll advance agreements to avoid recharacterization as a loan will be crucial for providers going forward.

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