

HOUSE BILL REPORT

ESSB 5312

As Reported by House Committee On:
Business & Financial Services

Title: An act relating to small consumer installment loans.

Brief Description: Authorizing small consumer installment loans.

Sponsors: Senate Committee on Financial Institutions, Housing & Insurance (originally sponsored by Senators Hobbs, Harper, Eide, Benton, Hatfield, Schoesler, Roach, Keiser and Tom).

Brief History:

Committee Activity:

Business & Financial Services: 3/27/13, 4/2/13 [DPA].

**Brief Summary of Engrossed Substitute Bill
(As Amended by Committee)**

- Creates a new small consumer installment loan regulated by the Department of Financial Institutions.
- Permits a loan of up to \$1,500 for a minimum of six months and a maximum of 12 months.
- Allows an origination fee of 15 percent of the loaned amount. A portion of the fee is refunded upon early repayment.
- Allows an interest rate of 36 percent per annum.
- Allows a maintenance fee of 7.5 percent of the total loaned amount per month with a maximum fee of \$90 a month.
- Provides for a repayment plan prior to any civil action upon a loan in default.
- Makes a number of potential borrowers ineligible for a small consumer installment loan.
- Creates prohibited practices for licensees.

HOUSE COMMITTEE ON BUSINESS & FINANCIAL SERVICES

This analysis was prepared by non-partisan legislative staff for the use of legislative members in their deliberations. This analysis is not a part of the legislation nor does it constitute a statement of legislative intent.

Majority Report: Do pass as amended. Signed by 13 members: Representatives Kirby, Chair; Parker, Ranking Minority Member; Vick, Assistant Ranking Minority Member; Blake, Chandler, Hawkins, Hudgins, Hurst, Kochmar, MacEwen, O'Ban, Santos and Stanford.

Minority Report: Do not pass. Signed by 2 members: Representatives Ryu, Vice Chair; Habib.

Staff: Jon Hedegard (786-7127).

Background:

State Usury Rate.

State law prohibits a rate of interest in excess of the usury rate on consumer loans unless those loans are exempt from the application of the rate. The rate is the higher of 12 percent per annum or a formula. For many years, the applicable usury rate has been 12 percent per annum. Under the usury laws, a setup charge may be collected for a loan of less than \$500. The setup charge is not considered interest. Generally, the setup charge must not exceed the lesser of:

- four percent of the amount of funds advanced; or
- fifteen dollars.

A number of loan products and types of lenders are exempt from the usury rate. There are a number of different regulatory frameworks for different types of lenders and loan products. The Consumer Loan Act (CLA) and the Check Cashers and Sellers Act (CCSA) provide frameworks for the regulation of unsecured consumer loans.

Consumer Loan Act.

A person may engage in the business of making secured or unsecured loans of money, if licensed by the Department of Financial Institutions (DFI) under the CLA. An applicant for a license under the CLA must maintain a surety bond in an amount based on volume of loans. The officers, directors, and owners of an applicant for an initial or a renewal license must undergo a background check, including submission of fingerprints to the Washington State Patrol (WSP) and the Federal Bureau of Investigation (FBI). There are a variety of requirements for licensees under the CLA, including record-keeping requirements. A licensee may not engage in a number of specifically prohibited practices. Generally prohibited are unfair and deceptive practices, fraud, misrepresentation, failure to make required disclosures, false or deceptive statements, and omitting material facts. There are administrative, criminal and civil penalties for violations of the CLA. A violation of the CLA is a per se violation of the Consumer Protection Act (CPA).

Terms of Loans Under the CLA.

Licensees under the CLA may charge interest in excess of the usury rate. A licensee may charge:

- up to 25 percent per annum as determined by the simple interest method of calculating interest owed; and
- a nonrefundable, prepaid, loan origination fee not to exceed 4 percent of the first \$20,000, and 2 percent of the sum above \$20,000. The fee may be included in the principal balance of the loan.

A CLA licensee may also offer an "open-end loan." An open-end loan is a revolving loan that allows the borrower to take advances up to the permitted amount. Charges are computed on the unpaid balance periodically. The borrower may pay in monthly installments that are fixed or determinable. The borrower may pay the full amount at any time without a prepayment penalty. Interest on an open-end loan must not exceed 25 percent per annum computed in each billing cycle calculated by any of the prescribed methods. A licensee may charge an annual fee of up to \$50, payable in advance, for opening and maintaining an open-end loan account.

Small Loans Under the Check Cashers and Sellers Act (Payday Loans).

The DFI oversees the CCSA. An applicant for a license under the CCSA must maintain a surety bond in an amount determined by the Director of the DFI (Director). The officers, directors, and owners of an applicant for an initial or a renewal license must undergo a background check, including submission of fingerprints to the WSP and the FBI. A licensed check casher or seller may make a payday loan only if the check casher or seller has an endorsement to their license. There are a variety of requirements for licensees under the CCSA, including record-keeping and reporting requirements. A licensee may not engage in a number of specifically prohibited practices. Generally prohibited are unfair and deceptive practices, fraud, misrepresentation, failure to make required disclosures, false or deceptive statements, and omitting material facts. There are administrative, criminal and civil penalties for violations of the CCSA. A violation of the CCSA is a per se violation of the CPA.

Terms of a Payday Loan.

A lender may not lend more than \$700 to a single borrower at any one time. The lender may charge a fee of up to 15 percent of the loaned amount for the first \$500. If the borrower has a loan in excess of \$500, the lender may charge a fee of up to 10 percent on the amount over \$500. The minimum term of a loan is the borrower's next paycheck unless that is less than seven days. If it is less than seven days, the minimum term is the date of the next following pay date. A borrower may not take out more than \$700 in payday loans at any time from all licensees. A borrower may not borrow more than 30 percent of his or her gross monthly income. Federal law prohibits fees or interest to exceed a calculation in excess of 36 percent annually for certain loans, including payday loans, made to a military borrower or the dependent of a military borrower.

Additional Provisions.

A licensee is prohibited from making a payday loan to a borrower that is in default on a payday loan or that is in an installment plan. A licensee is prohibited from making a payday loan to a borrower if making that loan would result in a borrower receiving more than eight payday loans in any 12-month period. An online computer system enables a licensee to verify if the potential borrower is eligible for a payday loan. There is a fee for the use of the system. A lender may not charge an additional sum to recover the fee. Information in the system is exempt from public disclosure. A borrower may rescind a payday loan, on or before the close of business on the next business day. A licensee may not charge the borrower a fee for rescinding the payday loan. A lender must inform the borrower that if the borrower cannot repay a loan when the loan is due, then the borrower may convert the payday loan to an installment plan. Payments must be in substantially equal installments on or after a borrower's pay dates and at least 14 days apart. A fee is not allowed for

establishing an installment plan. The borrower may pay the total at any time without a penalty. A licensee is prohibited from a number of specific practices when collecting a delinquent payday loan. There are additional state protections regarding collection of delinquent payday loans from military borrowers.

CPA.

The CPA prohibits unfair methods of competition and unfair or deceptive acts or practices in the conduct of trade or commerce. The CPA allows a person injured by a violation of the Act to bring a private cause of action for damages. The CPA also allows the Attorney General to bring an action in the name of the state or on behalf of consumers.

Financial Literacy and Education Programs.

The DFI is authorized to establish and implement financial literacy and education programs, including programs:

- to assist people of all ages in understanding saving, investing, and budgeting;
- to assist people of all ages in developing fiscal responsibility and obtaining individual financial independence; and
- regarding mortgages, predatory lending practices, and other financial products or practices relating to homeownership.

Summary of Amended Bill:

Small Consumer Installment Loan Act.

The Small Consumer Installment Loan Act (SCILA) is a new RCW chapter. No person may engage in advertising or making small consumer installment loans without first obtaining a license. Every small consumer installment loan made to a resident of Washington is subject to the authority and restrictions of the SCILA. A license is required for each location where a licensee makes small consumer installment loans.

Applications.

An application for a license must be filed together with an investigation and supervision fee established by rule by the Director. Each officer, director, and owner of an applicant must provide fingerprints for submission to the WSP or the FBI for a state and national criminal history background check. Each applicant must maintain a surety bond. The amount of the bond must be a minimum of \$30,000 and a maximum of \$250,000 based on the annual dollar amount of loans originated. The Director must investigate an applicant to determine the financial responsibility, experience, character, and general fitness of the applicant.

Terms.

The following provisions apply to small consumer installment loans:

- a maximum loaned amount of \$1,500 in aggregate to a borrower;
- substantially equal installment payments according to a schedule agreed to by the parties with not less than 14 days and not more than 35 days between each payment;
- a minimum loan term of six months;
- a maximum term of 12 months;
- the loan must amortize;

- the repayment obligation of a borrower is not secured by a lien on any real property or personal property; and
- the loan must be made primarily for personal, family, or household purposes.

Interest and Charges.

A licensee:

- may charge a loan origination fee not to exceed 15 percent of the loaned amount. If a borrower fully repays a loan prior to the date when full repayment is due, the licensee must provide a refund. The refund is equal to 50 percent of the origination fee multiplied by a fraction based on how early the loan was repaid;
- may charge 36 percent per annum on the outstanding unpaid principal balance of the loaned amount, exclusive of any fees, penalties, or charges;
- may charge a monthly maintenance fee up to 7.5 percent of the loaned amount. The monthly maintenance fee is capped at a maximum of \$90 per month. The monthly maintenance fee is earned after each 30 day period;
- is prohibited from making a small consumer installment loan to a borrower if the total of all scheduled payments to be made in any month exceeds 20 percent of the borrower's gross monthly income;
- may either charge a penalty of not more than \$25 and may declare the entire loan due and payable when a scheduled payment is 10 or more days delinquent;
- may collect reasonable attorneys' fees, actual expenses, and costs incurred in connection with the collection of any amounts due to the licensee; and
- is prohibited from charging a prepayment fee. A borrower may pay all or part of a loan before the maturity date without incurring any additional fee.

A licensee must not condition a small consumer installment loan on the borrower's repayment by preauthorized electronic fund transfers. A number of different payment options may be offered to borrowers.

Disclosure.

A licensee must post a schedule of the fees, penalties, and charges for taking out a small consumer installment loan in every location.

Transaction Record.

A record of each small consumer installment loan transaction must be authenticated by the licensee and the borrower. This record must include:

- the name and address of the borrower and the licensee;
- the transaction date;
- the loaned amount;
- a statement of the total amount of finance charges charged, expressed both as a dollar amount and an annual percentage rate;
- the installment payment schedule;
- the right to rescind the loan on or before the close of business on the next day of business at the location where the loan was originated;
- a notice to the borrower that any delinquency of a scheduled payment may result in a penalty of up to 10 percent of the delinquent amount and/or an acceleration of the loan payments;
- a description of the manner and methods by which loan payments may be made; and

- a notice that a small consumer installment loan is not intended to meet long-term financial needs.

A licensee must provide to its customer a receipt for each transaction. The receipt must include the name of the licensee, the type and amount of the transaction, and the fees and charges charged for the transaction.

Military Members.

Active and reserve duty military members, spouses of members, and dependent children of members are ineligible for a small consumer installment loan. A licensee may rely on a safe harbor, adopted by rule, in determining if a borrower is ineligible.

Other Ineligible Borrowers.

A borrower may not have simultaneous installment loans at multiple lenders. A borrower may not have a payday loan and a small consumer installment loan simultaneously.

Rescission.

A borrower may rescind a small consumer installment loan before the close of business on the next day of business at the location where the loan was originated. A licensee may not charge the borrower for rescinding the loan and must refund any loan fees and interest. The right of rescission must be conspicuously disclosed in the loan agreement.

Repayment Plan.

A repayment plan is created for borrowers who default on a loan. A licensee must offer a borrower a repayment plan prior to bringing a civil action on a loan in default. The offer must be open to the borrower for at least 30 days. A repayment plan must be for at least 90 days unless the borrower agrees to a shorter term. A licensee may charge up to 20 percent of the total defaulted amount as an initial payment. A licensee may charge fees and sums incurred prior to the default and the applicable delinquency fees. A licensee may not charge any other fee or interest for a repayment plan. If a borrower defaults on a repayment plan, a licensee may pursue any legal remedy to collect the outstanding balance on the repayment plan.

Collections.

A licensee is prohibited from a number of specific practices when collecting a delinquent loan.

Restriction on Transfer.

A small consumer installment loan may only be pledged, sold, or assigned to another licensee or to a bank, savings bank, trust company, savings and loan or building and loan association, or credit union.

Prohibited Practices.

There are a number of prohibited practices for a licensee, its officers, directors, employees, and independent contractors, and any other person subject to the SCILA. Generally prohibited are unfair and deceptive practices, fraud, misrepresentation, failure to make required disclosures, false or deceptive statements, and omitting material facts. Any transaction that in violation of a prohibited practice is uncollectible and unenforceable.

Internet Lending.

A licensee may advertise and accept applications for small consumer installment loans by any lawful medium, including the internet. A person that is not licensed is prohibited from advertising or making small consumer installment loans via the internet.

Fees.

Each applicant and licensee must pay:

- an investigation or examination fee as established in rule by the Director; and
- an annual assessment fee determined in rule by the Director.

Record-keeping.

A licensee must maintain books, accounts, and records as required in rule by the Director for at least two years from the completion of a transaction.

Examination or Investigation.

The Director may examine and investigate any licensee or person who the Director has reason to believe is engaging in the business governed by the SCILA. The Director may examine any person under oath about a licensee's business or the subject matter of an investigation. The Director may require the production of original books, accounts, records, and files or copies of such information. The Director must collect the actual cost of an examination or investigation from the licensee that is being examined.

Reporting Requirements.

Each licensee must submit financial statements to the Director and any additional relevant information as the Director may require. Information provided by a licensee is exempt from public disclosure unless aggregated with other information in a manner that individual information is not identifiable.

Sanctions.

The Director may impose sanctions against any licensee or applicant, or the directors, officers, sole proprietors, partners, controlling persons, or employees of a licensee or applicant including:

- the denial, revocation, or suspension of a license;
- ordering the licensee or person to cease and desist from practices that violate the SCILA;
- imposing a fine not to exceed \$100 per day per violation;
- ordering restitution or refunds to borrowers or other affected parties; and
- prohibiting any director, officer, sole proprietor, partner, controlling person, or employee of a licensee from participating in the business.

CPA.

A violation of the SCILA is a per se violation of the CPA.

Database.

The Director may adopt rules regarding a database system, including establishing fees for the use of the database. The Director may contract with a vendor for the operation of the database.

Financial Literacy and Education.

One dollar from each small consumer installment loan transaction must be remitted to the DFI to be used for financial literacy and education.

Rules.

The Director must adopt rules to implement and administer the SCILA.

Adjustments to Dollar Amounts.

Each July, the Director must annually adjust the specified dollar amounts in the SCILA for inflation to reflect changes in the Consumer Price Index published by the United States Department of Labor. The adjusted amount must be rounded up to the nearest \$5.

Veto Provision.

If any portion of the act is vetoed by the Governor, the entire act is null and void.

Report.

The Director must provide a report on regarding small consumer installment loans by December 1, 2015.

Amended Bill Compared to Engrossed Substitute Bill:

The maximum length of a small consumer installment loan is reduced to 12 months. If a borrower fully repays a loan prior to the date full repayment is due, a licensee must provide a refund up to 50 percent of the origination fee based on how early the loan was repaid. The monthly maintenance fee is earned after each 30 day period. The monthly fee is capped at a maximum of \$90 per month. Delinquency fees are capped at a maximum of \$25 per delinquent loan. A licensee must offer a borrower a repayment plan prior to bringing a civil action on a loan in default. A repayment plan must be for at least 90 days unless the borrower agrees to a shorter term. A licensee may charge up to 20 percent of the total defaulted amount as an initial payment. A licensee may only charge fees and sums incurred prior to the default and the applicable delinquency fees. Additional disclosure language is prescribed. Military members, spouses of members, and dependent children of members are ineligible for a small consumer installment loan. A borrower may not have simultaneous installment loans at multiple lenders. A borrower may not have a small loan (also known as a payday loan) and a small consumer installment loan simultaneously. One dollar from each small consumer installment loan transaction must be remitted to the DFI to be used for financial literacy and education.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Amended Bill: The bill takes effect 90 days after adjournment of the session in which the bill is passed. However, the bill is null and void if any portion of the bill is vetoed by the Governor.

Staff Summary of Public Testimony:

(In support) There is a need for a loan that is more consumer-friendly than a payday loan. The bill needed more work after it came out of the Senate. The striking amendment addresses many of the issues. Military members and their families should be ineligible for these loans. Military services provide low-interest credit options that can be accessed by members. Perhaps that should be additional required disclosure. The striking amendment provides a safer, cheaper, more flexible alternative to a payday loan. There is a financial incentive to pay the loan off early. A borrower does not have to pay new origination fees. There is a limit on the number of loans. The same type of database used to enforce payday lending laws can be used to enforce similar restrictions with this new loan product. People who cannot access a payday loan because of the eight-loan cap may seek an unregulated, illegal loan.

Payday lenders are licensed and heavily regulated. Payday lenders' products and practices are fair and transparent. Legislators have asked the payday lending industry for an installment loan product. The striking amendment is an installment product that has many other consumer protections. The loan is fully amortized. Under the striker, 50 percent of the origination fee is refundable. There is a maintenance fee that is capped at \$90 a month. A borrower can prepay a loan without penalty. There is a right to rescind the loan. The penalty for default is \$25. Military borrowers are ineligible. A repayment plan must be offered. There is a \$1 fee to fund financial literacy. There is a limit on the number of loans a borrower may have per year. When used like a payday loan, this product is more affordable. In Colorado, a vast majority of borrowers pay similar loans off early because of the financial incentives. It is more flexible than a payday loan. This product addresses the requests of legislators and consumers. Surveyed payday loan customers preferred an installment loan product two to one over a traditional payday loan. Currently, illegal internet loans are an issue. These lenders do not contribute to the tax base and are not regulated. Those loans have no consumer protections. Not all of the striking amendment is supported by industry. The Colorado law is supported by consumer advocates. It is not clear why it is not supported here. Many payday loan opponents simply oppose the bill because of who the lenders are rather than the terms of the loan products. For several years, the industry has been told to provide a different type of loan. Additionally, the growth in illegal internet lending is rapid. The trend in consumer lending is online loans. The DFI indicates that most online payday lenders are not licensed in the state and are making illegal loans. The striking amendment is an improvement on the Colorado model. Industry is not comfortable with all of the provisions of the striker. Reports show that the Colorado laws have reduced costs to borrowers while improving consumer protections. The striker provides all of the protections that have been asked for by consumer advocates. A number of union and minority groups have provided written support for the bill. The DFI numbers show the striking amendment is better than the existing alternatives.

(Other) These loans may be transferred to banks and credit unions. Consumer loan companies should also be eligible to receive these loans.

(Concerns) The Department of Defense has concerns about the existing Senate bill. It does not provide the types of protections that are available under federal law. The National Guard has concerns about the Senate bill. Debt and credit scores affect military readiness and the

ability of military members to secure and retain security clearances. Federal law protects active military members, but no laws protect members of the reserves. The military invests considerable money into each military member. The language in the striking amendment protects military members and should be included in any version of the bill that may be passed.

(Opposed) A new payday loan product is not desired by consumers. The proposed changes in the striking amendment make the product better, but they do not resolve the outstanding issues regarding the costs of these loans. Interest can reach over 190 percent. New origination fees can be paid up to 12 times a year. Protecting the military is a good idea but civilians should have the same protections. The existing payday laws better protect consumers than this new product. This new product is predatory and can trap people in cycles of debt. A high percentage of unbanked or under banked consumers access high-interest loans. There are credit unions that offer cheaper products with built-in savings components and offer financial education. This product will not help payday loan borrowers.

The striking amendment was not available until last night and is still being reviewed. This product has three different types of fees: origination, monthly, and annual. That is very complicated for a short-term loan product. For a \$1,000 loan, a borrower will pay over \$1,500 in fees over twelve months. That is excessive. The change in the origination fee is only up to 50 percent of the fee. Colorado allows a refund of the whole origination fee. The monthly maintenance fee and the origination fee are not defined in the bill. The number of fees is unprecedented. The repayment plan is available prior to a lawsuit. It is not available upon request of the borrower. Colorado does not allow a post-dated check. This product is not good for Washington consumers. People in low-income communities are not looking for a new type of predatory loan. Payday loans have destroyed people's lives. This product is being developed for lenders, not for borrowers.

Responsible lending is a moral issue. Usury is opposed in many faiths. Scripture warns against usurious practices. A payday loan seems to be a life raft but it is really a millstone. Triple digit interest rates and exorbitant fees trap borrowers in a cycle of debt. The bill and the striking amendment should be opposed. Seventeen advocacy groups opposed the Senate bill in the Senate. Only payday lenders supported the bill in the Senate. Society should protect those people on the financial margins. The bill undermines existing consumer protections. The bill sanctions outrageous profits. Fairness and honesty in business is paramount. High-cost loan products should not be legalized. Loans should strengthen the borrower. These loans will weaken the borrowers, make them dependent, and trap them in a cycle of debt. Payday loans can lead to homelessness. A predatory loan is not an answer to the problem of a lack of credit. Consumers need a fair, reasonably priced product. A payday loan adds a new financial pitfall for a person that is in debt. Perhaps a better alternative is providing information to consumers on better ways to address credit and debt issues.

Persons Testifying: (In support) Senator Hobbs, prime sponsor; and Dennis Bassford and Trent Matson, Money Tree.

(Other) Tom Echols, Washington State Financial Services Association.

(Concerns) Mark SanSouci, Department of Defense State Liaison Office; and Major Matthew Cooper, Washington National Guard and Washington Military Department;

(Opposed) Marcy Bowers, Statewide Poverty Action Network; Joe Sky-Tucker, Express Credit Union; Bruce Neas, Columbia Legal Services; Peter Zimmerman; Jackie O'Ryan, Faith Action Network; George Keefe; Rabbi Seth Goldstein, Jewish Coalition for Justice; Derek Taylor, Wellspring Family Services; Katrina Ondracek, United Way of Snohomish County and Snohomish County Asset Building Coalition; and Steve Breaux, Service Employees International Union 775.

Persons Signed In To Testify But Not Testifying: None