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REGULATE PAYDAY LENDING

House Bill 5641 (Substitute H-3)
First Analysis (12-3-02)

Sponsor: Rep. Randy Richardville
Committee: Insurance and Financial Services

THE APPARENT PROBLEM:

A relatively new industry, known as payday lending or check advance services, has been growing rapidly in Michigan and nationwide. Payday lenders operate in at least 30 states and the number of outlets has been estimated at from 6,000 up to 12,000 in various reports. The Lansing State Journal reported on September 30, 2002, that 13 pay advance centers operate in the greater Lansing area, including 11 that have opened in the past two years. In this quickly expanding business, a customer can obtain a short term loan, typically for 14 to 30 days. The transaction is consummated when a customer writes a personal check for an amount ranging from $50 to $1,000 and pays a fee, ranging from $17 to $20 per $100 borrowed, to the lender. In exchange, the lender gives the customer cash and agrees to hold the personal check for the agreed upon period of time. At the end of the loan period, the customer must either come in and redeem the check for its face amount in cash, or the check is deposited by the lender and the customer's checking account is debited for the amount owed. In some cases (some would argue in many cases), the borrower pays off one loan by taking out another, or simply renews an existing loan. This aspect, rolling over one loan to pay off another, transforms what is supposed to be a short term transaction into an extremely high cost long term loan, with fees comparable to an annual interest rate (APR) of 300 percent to 900 percent.

There appears to be substantial consumer demand for these services, as evidenced by the growth in outlets and the earnings of companies in this business. The payday advance industry describes its typical customer as an employed individual earning an average of $25,000 to $45,000 per year, who has an active checking account. The industry describes payday advance as a cost effective alternative to bouncing checks and paying late fees for overdue bills. An industry survey reports that over 75 percent of customers were satisfied with their most recent payday advance transaction, and that 92 percent of customers believe the service to be useful.

The legal and regulatory status of the payday lending industry is in flux. Some states explicitly permit payday lenders to operate and require some form of licensure or regulation; some states prohibit the practice; and in others, payday lenders are subject to the state's small loan or criminal usury laws, which typically limit interest rates to a specified level. In Michigan, a 1995 declaratory ruling of the Financial Institutions Bureau (the predecessor agency to the Office of Financial and Insurance Services) within the Department of Consumer and Industry Services concluded that payday advance transactions are subject to the Regulatory Loan Act. The ruling stated that engaging in this type of transaction without a license and full compliance with the act would constitute a violation of the act, as well as the general usury laws, and the Criminal Usury Act. (Interest charged on loans subject to the Regulatory Loan Act is limited to a maximum APR of 25 percent. Further, the state's criminal usury law prohibits charging more than 25 percent in simple interest per annum "or the equivalent rate for a longer or shorter period".) However, despite the ruling, the state is not regulating the payday advance industry, and there are no specific restrictions on the fees that may be charged or the number of times a borrower may renew a loan.

Consumer advocates charge that payday loan transactions are exorbitantly expensive, and that the industry preys upon people who are financially vulnerable and designs their short-term loans to perpetuate a cycle of high-cost debt. Industry representatives maintain that they fill a market niche for short-term loans that exists because traditional lenders generally do not offer short term, small-denomination loans, and that customers are satisfied with the services they provide. Payday lending providers seek specific authorization to operate in Michigan, and legislation has been introduced to recognize this type of business and establish a regulatory framework.

THE CONTENT OF THE BILL:

The bill would create the "Deferred Presentment Services Act". It would specifically authorize the provision of deferred presentment services, which would be defined as transactions in which a provider agrees to pay to a customer an agreed-upon amount of money in exchange for a fee, and agrees to hold the customer's check for a period of time before negotiation, redemption, or presentment of the check. The bill would require providers of deferred presentment services to document transactions by entering into written agreements with customers, require providers to post certain notices, establish limitations on fees, prohibit renewal of deferred presentment service agreements, require providers to provide certain information to the Office of Financial and Insurance Services, and establish civil penalties for violations. The bill would take effect July 1, 2003.

Existing businesses. The bill specifies that a person who provided deferred presentment services before July 1, 2003 would be considered to have complied with applicable state law if he or she provided the services in substantial conformity with the rulings then in effect that were issued by the OFIS or its predecessor agency.

Notice of doing business. Beginning July 1, 2003, a person would have to provide notice to the Office of Financial and Insurance Services, at least 30 days before commencing operation, and supply the OFIS with the name, address, and telephone number of the person's principal place of business and of each business location, and of each executive officer. If no physical business location will be operated in the state or if in addition to the physical locations the person plans to offer deferred presentment services by another means, the notice would have to include a detailed description of the manner in which services would be offered to customers in the state. In addition, the commissioner of OFIS could require other information considered necessary.

A person who was operating as a provider before January 1, 2003 would have to provide the written notice described above no later than 30 days after the effective date of the bill.

In addition, a provider would have to give notice at least 15 days before commencing business at a new location or in a new manner, and at least 15 days before discontinuing services. A provider would have to submit a correction at any time that any information previously submitted is no longer accurate.

Reports to the OFIS. At least annually and within a reasonable time after requested by the commissioner, a provider would have to provide a written report of its business operations, including business volume and other information as requested by the commissioner.

In addition, each February 1, May 1, August 1, and November 1, a provider would have to report all of the following regarding violations (see below) to the commissioner:

- The number of customers who notified the provider of a violation of the bill during that quarter.

- A breakdown of the number of times the provider agreed that a violation occurred and the number of times that the provider did not agree that a violation occurred.

- The amount of restitution paid to the customer when the provider agreed that a violation occurred.

- Any other information considered necessary by the commissioner.

Business operating fee. The commissioner would annually establish a schedule of fees based upon business volume, number of locations, and other reasonable factors designed to generate sufficient funds to pay (but not exceed) the office's reasonably anticipated costs of administering the bill. A provider would also be required to pay the actual travel, lodging, and meal expenses incurred by OFIS employees who travel out of state to examine the records of or investigate a provider.

Money received from fees would be deposited in the state treasury and credited to the OFIS to be used only for the operation of the office.

Surety bond. A provider would be required to furnish a $50,000 surety bond to secure the performance of his or her obligations under the bill.

Records. The bill would require providers to maintain records of transactions for at least three years, and make the records (and related documents such as applications, credit reports, employment verifications, and loan disclosure statements) available for examination by the commissioner.

Further, a provider would have to preserve and keep available for examination all documents pertaining to a rejected application for a deferred presentment services agreement for a period of time required by law.

Required notices. A provider would be required to prominently post certain notices so that customers could see them before entering into deferred presentment services agreements. The bill contains specific language to be posted, including descriptions of many of the bill's provisions spelling out requirements for providers, the right of customers to cancel agreements, the prohibition on customers having more than one agreement in effect at a time, and so forth, and including the toll-free telephone number of the OFIS.

In addition, the bill would require that a transaction agreement contain certain notifications to the customer, including that deferred presentment service agreements are not intended to meet long-term financial needs, that a customer should use the service only to meet short-term financial needs, and a summary of the process for reporting an alleged violation of the bill to the provider. In addition, a transaction agreement would have to contain an itemization of fees charged, and a clear description of the customer's payment obligation.

Deferred presentment transactions. A provider could enter into a deferred presentment services agreement with a customer for any amount up to $1,000, plus a service fee of up to 18 percent of the amount paid to the customer.

A provider could not enter into a transaction with a customer if the customer had another deferred presentment services agreement that had not been fully repaid. A provider would be considered to be in compliance with this requirement if he or she used due diligence to determine whether the customer had any outstanding agreements with that provider or its affiliated companies, and who obtained a certification from the customer that the customer had no outstanding agreements. A customer who entered into an agreement in violation of this requirement would not be entitled to certain remedies in the case of a violation of the bill by the provider.

At the time of entering into a deferred presentment services agreement with a customer, a provider would be required to provide a copy of the agreement to the customer, and to pay the proceeds under the agreement in cash if requested by the customer.

A provider could not:

- Charge interest under the agreement;

- Include a maturity date that was more than 31 days after the date of the agreement;

- Charge an additional fee for cashing the provider's business check;

- Include a confession of judgment in an agreement (a confession of judgment is a statement by a debtor permitting judgment to be entered against him or her by a creditor, for a stipulated sum, without legal proceedings);

- Charge or collect any other fees except as provided by the bill;

- Refuse to provide a deferred presentment service to a customer solely because the customer had exercised his or her rights under the bill;

- Renew a deferred presentment services agreement (a provider could extend an agreement only if he or she charged no fee to do so, and an extended agreement could not create a balance owed above the amount owed on the original agreement); or,

- Present a check for payment before the maturity date (a provider who violated this provision would be liable for all expenses and damages caused to the customer as a result of the violation, in addition to other penalties under the bill).

The bill specifies that if a customer has satisfied his or her obligation under a deferred presentment services agreement, any provider could enter into a new agreement with that customer. If a check being held by a provider was presented and paid, or if the customer had redeemed the check by paying to the provider the full amount of the check, then the customer's obligation would be satisfied.

A provider would be required to endorse a check given to it by a customer with the actual name under which the provider is doing business.

A provider could contract for and collect a returned check charge of up to $25 if a check held under a deferred presentment services agreement was returned due to insufficient funds, a closed account, or a stop payment order. In addition, a provider could exercise any other legal remedy available by law in connection with a check being returned due to a closed account or a stop payment order.

Customer rights. A customer could rescind a deferred presentment service agreement at no cost and for any reason if he or she delivered to the provider, no later than the close of business on the business day following the date of the agreement, cash or an equivalent in an amount equal to the amount of cash received by the customer under the agreement. The provider would have to return the customer's check and any fees paid. A customer who rescinded an agreement would not be eligible for restitution.

In addition, a customer would have the right to redeem a check from the provider holding the check at any time before the maturity date by paying the full amount of the check in cash or an equivalent.

A customer could not be subject to any criminal penalty for entering into a deferred presentment services agreement, and would not be subject to any criminal penalty if his or her check were dishonored.

Customer complaints to providers. A customer who believed that a provider had violated the bill would have to notify the provider of the violation. The notification could be made in person before the close of business on the day he or she signs an agreement, or could be made in writing within five business days. In either case, the customer would have to identify the nature of the violation and provide documentary or other evidence of the violation. The provider would have to determine, within three business days after being notified of an alleged violation by a customer, whether it had violated the law as alleged.

If the provider determined that a violation had occurred, it would be required to return to the customer the check received under the agreement, along with any cash fees paid by the customer. The customer would have to return to the provider the money he or she received under the agreement. Further, the provider would have to make restitution to the customer for each violation in the amount of five times the amount of the fee charged, but not less than $15 nor more than the face amount of the customer's check. A provider who made restitution under these provisions would not be subject to any other remedy provided under the bill for that violation.

If the provider determined that a violation had not occurred, the it would be required to immediately notify the commissioner and the customer of its determination, and provide information about the complaint to the commissioner. The customer would also have to be notified of his or her right to file a written complaint with the OFIS and given information as to how to obtain a complaint form.

If the provider had otherwise complied with these requirements and determined that it did not violate the bill, the provider could then present the customer's check for payment on or after the maturity date. If the check were not honored, the provider could initiate lawful collection efforts.

Complaints to OFIS, investigations. A customer could file a written complaint with the OFIS, following a report of a violation made to a provider (as described above). A customer could also complain directly to the OFIS. A complaint would have to be accompanied by documentary or other evidence of a violation or activities of a provider. The commissioner would be required to promptly investigate a complaint filed by a customer. If, after investigation, the commissioner concluded that the provider violated the bill, the commissioner could order the provider to make restitution to the customer in an amount equal to three times the amount of the fee charged, but not less than $45 nor more than three times the amount of the customer's check. Further, the provider would also be subject to other remedies and penalties.

The commissioner could investigate or conduct examinations of a provider and conduct hearings as considered necessary to determine whether a provider or any person had violated the bill, or whether a provider had conducted business in such a manner that would justify suspension or forfeiture of its authority to conduct business in the state. The commissioner could subpoena witnesses and documents, papers, books, records, and other evidence; and administer oaths and affirmations to persons whose testimony was required. Further, the commissioner could petition the Ingham County Circuit Court to order a person to attend and give testimony or produce evidence.

Violations, penalties. The bill states that a provider who failed to provide the required notification, failed to provide or misreported required information, failed to pay the required operating fee, or engaged in a pattern of practice that poses a threat of financial loss or threat to the public welfare would forfeit its authority to continue operating as a provider of deferred presentment services. The commissioner could serve a notice of intention to suspend or forfeit the provider's authority to continue operating, which would have to state the facts constituting the violation or pattern of practice and fix a time and place for a hearing. If the provider failed to appear at the hearing, the provider would be considered to have consented to the forfeiture of his or her authority to operate. In that case, or, upon the commissioner's finding on the record at a hearing of a violation, the commissioner could serve an order on the provider suspending or forfeiting his or her authority to continue operating.

In addition to forfeiture of the authority to operate, a provider who was found to be in violation of the bill, state or federal law, or other applicable rule or regulation would be subject to a civil fine of up to $10,000 for each violation. And, if the person knew or reasonably should have known that he or she was in violation of the bill, the fine could be up to $50,000. The commissioner could also order the provider to pay the costs of the investigation.

The commissioner could sue and recover a fine assessed under the bill, and the attorney general could collect and enforce a fine by summary proceedings. In considering the amount of a fine, the commissioner would be required to consider the extent to which the violation was a knowing and willful violation, the extent of the injury suffered because of the violation, the corrective action taken by the provider to ensure that the violation would not be repeated, and the record of the provider in complying with the bill.

Application of the Administrative Procedures Act. The bill states that a person ordered to cease and desist, to suspend or forfeit its authority to continue operating, or to pay a fine under the bill would be entitled to a hearing before the commissioner upon making a written request within 30 days after an order takes effect. Proceedings under the bill would be subject to the Administrative Procedures Act. In addition, the commissioner would be authorized to promulgate rules to implement the bill.

FISCAL IMPLICATIONS:

According to the Office of Financial and Insurance Services, the bill would place increased demands on the office and necessitate the use of more staff time. This will either take staff away from other necessary functions or require the addition of new staff. (11-13-02)

ARGUMENTS:

For:

At present, the business of providing payday loans is unregulated in Michigan, and there are no specific limitations on the amount of fees charged, and no prohibition against rolling over transactions in an unending cycle. Although many in the industry have voluntarily adopted “best practices” that call for full disclosure to customers, truthful advertising, appropriate collection practices, self-policing, and so forth, placing these practices into statute will further protect consumers. The bill would regulate the practice of providing deferred presentment services (a name used to denote that the transactions are not actually loans, but services provided for a fee). Under the bill, maximum fees would be established and additional charges or interest would not be allowed. Customers would be prohibited from renewing these transactions or from taking out more than one at a time. In addition, the bill would require providers to notify their customers of the rights and protections they have under state law, including the limits on fees and the complaint process, by posting notices on the wall and by including it in the written transaction agreement, which would have to be provided to the customer. A customer would have the right to completely rescind a transaction within the first day, and get his or her money back. Providers would be prohibited from pursuing criminal remedies against customers for dishonored checks.

Providers would have to file notice with the Office of Financial and Insurance Services of their intent to do business in the state, and the OFIS would have regulatory oversight. The OFIS could charge business operating fees to pay the costs of oversight. The OFIS could examine a business’ records, respond to customer complaints, order a provider to pay restitution to an injured party, order providers to pay civil fines for violations, and issue cease and desist orders.

Industry representatives argue that the cost of deferred presentment services is fair and reasonable when compared with alternative sources of short term credit that are actually available to many consumers. The actual alternatives to the use of these short term loans, for many people, are things like returned check fees, late payment fees, reconnect fees for utilities, and contract default fees. The industry argues that the use of APR equivalents to measure the cost of deferred presentment services is a poor comparison, because these transactions are designed to be very short term transactions, where APR calculations better reflect the cost of long term loans. In terms of the actual dollar cost of a deferred presentment services transaction compared to returned check fees, reconnect fees, and so forth, these transactions compare favorably and are a convenient and dignified alternative for many consumers.

Against:

The payday lending industry is growing extremely rapidly due to the lucrative nature of the business. According to national consumer protection organizations, this industry is using multiple strategies to extend its ability to operate unfettered, including forming partnerships with federally-chartered banks in order to evade state laws designed to protect consumers from exorbitant interest rates. And, in case Congress outlaws this practice, the industry is lobbying legislatures in 27 states for laws similar to the one proposed by the bill.

Michigan should not legalize a practice that produces huge profits by exploiting the financial desperation of people who are living from paycheck to paycheck. No matter what terminology is used, the payday lending industry is a purveyor of extremely high cost loans, and to authorize the industry to operate in Michigan is to legitimize an industry that some have called "legalized loan sharking" and "the crack cocaine of credit". The bill would allow a provider to charge up to 18 percent on the amount borrowed. Since the typical loan is for two weeks, this equates to an APR of 468 percent! These transactions are typically repeated, because lenders generally do not allow borrowers to make partial payments so that they can whittle down the amount of principal owed; instead borrowers are required to pay off the entire loan at one time. This sets up a cycle: as soon as a person uses his or her paycheck to pay off the first loan, he or she is immediately broke again and probably in need of another loan. Though the bill would prohibit a provider from renewing or rolling over a loan, it would not prohibit a person from immediately taking out a new loan the minute the first one is paid off. People who have fallen into this cycle are repeatedly paying the "service fee" and find it nearly impossible to pay off the principal. There are many reported cases of people paying thousands of dollars in "fees" and still owing the lender in a never ending cycle.

As it was originally introduced, the bill proposed to license payday lenders and to establish reasonable limits on interest charges and fees. It would have permitted consumers to make installment payments on loans, and would have instituted more meaningful barriers against rollovers. It contained stricter penalties and enforcement provisions, and a meaningful complaint process. And, it would have required lenders to comply with disclosure requirements under the federal Truth in Lending Act, most significantly the requirement that the annual APR interest calculation be disclosed. In contrast, the committee substitute provides much less in the way of consumer protection. The substitute no longer provides for licensure, but for a kind of "self-regulation". It omits federal Truth in Lending disclosure, does not provide for a private cause of action for injured parties, and no longer contains any criminal penalties. It does not explicitly require the OFIS to actively monitor these businesses, but only requires it to respond to complaints. The burden of proving a violation of the law appears to fall on the customer, who is encouraged to first complain to the lender and wait for the lender to determine its own culpability!

To truly protect consumers, the legislature has other options: it could simply prohibit the practice of payday lending, or it could require the industry to comply with usury laws that apply to other kinds of lenders. It could adopt a licensure system, cap the allowable fees at a more reasonable level, and require lenders to accept installment payments on loans. In addition, it could provide for meaningful regulation and enforcement, and require the Office of Financial and Insurance Services to closely monitor and investigate these businesses.

POSITIONS:

Check 'n Go of Michigan, Inc. supports the bill. (11-20-02)

The Community Financial Services Association of America supports the bill. (11-22-02)

The Office of Financial and Industry Services in the Department of Consumer and Industry Services does not oppose the bill. (11-21-02)

The Michigan Consumer Federation opposes the bill. (11-20-02)

The Michigan Advocacy Project opposes the bill. (11-20-02)

The UAW-Michigan CAP opposes the bill. (11-22-02)

The AFL-CIO opposes the bill. (11-26-02)

The AARP of Michigan opposes the bill as written and believes that the 18 percent fee allowed is usurious. (11-26-02)

The Office of the Attorney General opposes the committee substitute. (11-27-02)

Analyst: D. Martens

■This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.