

HOUSE BILL REPORT

HB 1743

*As Reported By House Committee on:
Financial Institutions & Insurance*

Title: An act relating to consumer loans.

Brief Description: Revising regulation of high-interest consumer loans.

Sponsor(s): Representatives Dellwo, Broback, R. Meyers, R. Johnson, Dorn, Zellinsky, Paris, Scott and Winsley.

Brief History:

Reported by House Committee on:
Financial Institutions & Insurance, February 14, 1991,
DPS.

**HOUSE COMMITTEE ON
FINANCIAL INSTITUTIONS & INSURANCE**

Majority Report: *That Substitute House Bill No. 1743 be substituted therefor, and the substitute bill do pass.*
Signed by 12 members: Representatives Dellwo, Chair; Zellinsky, Vice Chair; Broback, Ranking Minority Member; Mielke, Assistant Ranking Minority Member; Anderson; Inslee; R. Johnson; R. Meyers; Paris; Schmidt; Scott; and Winsley.

Staff: John Conniff (786-7119).

Background: Washington statutes permit the licensing or incorporation of consumer loan companies under either of two statutes - the Consumer Finance Act or the Industrial Loan Act. Both acts permit companies to charge rates in excess of the state usury statute and both acts place the supervision of such companies with the state Supervisor of Banking. Many, if not most companies hold dual authority under both acts.

Consumer finance companies are licensed after showing that the company has \$50,000 in liquid assets and a \$2,500 bond for each location. Under the act, allowable interest rates are determined in accordance with the amount of the loan. Loans are limited to \$2,500 not to exceed a term of forty-eight and one-half months with the permitted rate ranging from a high of two and one-half percent for loans under \$500 to one percent on the portion of a loan amount exceeding

\$1000. Consumer loan companies are permitted to use the "add-on" method of calculating interest.

Industrial loan companies are issued a certificate of authority after obtaining approval of their articles of incorporation and capital structure. Such companies are restricted as to their increases or decreases in capital stock, their required cash reserves, their real estate holdings, their dividends, their accounting for bad debts, and their investments. Under the act, allowable interest rates are determined three ways. Loans under two years may be calculated using the discount method with a maximum 10 percent annual interest rate. All other loans may not exceed 25 percent per year. In addition, companies may charge a two percent loan fee. Finally, companies are authorized to issue open-end loans (lines of credit) at a maximum rate of 25 percent per year.

Summary of Substitute Bill: The existing Industrial Loan Act is repealed effective January 1, 1993. In place of each act, a new Consumer Loan Act is created combining elements of both the repealed acts.

Many current sections of the law are repealed without replacement in recognition of the fundamental changes which have occurred over the past decades in the way industrial loan companies conduct business. For example, no industrial loan company issues investment certificates which the existing law anticipates. In addition, many repealed sections of the existing Industrial Loan Act concern the solvency or business structure of a loan company intended to prevent insolvency because of the deposit taking function of early company practices. Similarly, statutory requirements for regulatory exams of company solvency are repealed. In place of the repealed provisions the draft incorporates the licensing procedure now governing consumer finance companies.

Existing statutory provisions governing industrial loan company business structure, business capital, and other regulatory tests are repealed. To ensure sufficient assets to pay fines, penalties, or judgments for violations of the new act, loan companies must either post a bond of \$100,000 for each of the first five company offices and \$10,000 for each additional office or a loan company may maintain sufficient unimpaired capital and surplus.

Existing statutory provisions allowing companies to use various methods in calculating interest and unearned interest rebates are repealed and newer simplified requirements are imposed. The existing varied interest rate structure of both the Consumer Finance and the Industrial

Loan Acts are replaced with a flat maximum permitted interest rate of 25 percent per year. Companies are permitted to increase their loan origination fee from 2 percent to 4 percent.

Companies are prohibited from using the lender favored rule of 78's in calculating interest rate refunds and from using the discount method for calculating new loans. Prepayment penalties are not permitted. In addition, the use of the add-on method for precomputed loans is retained but limited to loan terms not exceeding three years and 15 days. However, if the borrower prepays two or more installments on a loan calculated by the add-on method and continues to pay the loan in advance, the loan must be recalculated as if the loan had been made using a simple interest method of calculating borrower payments. All existing statutory provisions governing open-end loans are retained.

Finally, new provisions are added which allow both greater regulatory authority by the supervisor and clearer responsibilities on the part of the loan companies. New definitions are provided for methods of calculating interest accompanied by rule making authority to further explain these methods. Record maintenance procedures are simplified. Regulatory fees are revised and retained. Insurance sales and practices of loan companies must conform in all respects with the insurance code. The supervisor is granted clear authority to adopt all rules necessary to ensure full disclosure to borrowers and to interpret the new loan act. The supervisor may also issue cease and desist orders for companies conducting business in an injurious manner or in violation of the new act.

Substitute Bill Compared to Original Bill: Technical changes are made and the Consumer Finance Act's exemption of certain lenders is retained.

Fiscal Note: Not requested.

Effective Date of Substitute Bill: This bill takes effect January 1, 1992, except for section 23, repealing the Consumer Finance Act which takes effect January 1, 1993.

Testimony For: The Industrial Loan Act and Consumer Finance Act contain many outdated provisions. The consolidation and revision of the two acts will recognize modern lending and business practices, will simplify both regulatory compliance and oversight, will provide better consumer protection, and will clarify lending authority. The revision is the product of lengthy negotiations to achieve a balance between consumer protection and business needs.

Testimony Against: None.

Witnesses: Lew McMurrin, Household International (Pro); Susie Tracy, Washington State Financial Services Association (Pro); Jerry Gordon, Beneficial (Pro); Earle Murray, Beneficial (Pro); and Tom Oldfield, Supervisor of Banking.