
Business & Financial Services Committee

ESSB 5312

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 Summary of Engrossed Substitute Bill

- Provides for a new unsecured consumer loan.
- Creates a new chapter providing a regulatory framework for the Department of Financial Institutions to license the makers of small consumer installment loans.
- Permits loan terms of up to \$1,500 for a minimum of six months.
- Allows an origination fee of 15 percent of the loaned amount, an interest rate of 36 percent per annum, and a maintenance fee of 7.5 percent of the total loaned amount per month.
- Creates prohibited practices for licensees.

Hearing Date: 3/27/13

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.

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.

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.

Consumer Protection Act.

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.

Summary of 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 of the DFI (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 18 months;
- the loan must amortize;
- the repayment obligation of a borrower is not secured by a lien on any real property; and
- the loan must be made primarily for personal, family, or household purposes.

Interest and Charges.

A licensee:

- 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 loan origination fee not to exceed 15 percent of the loaned amount;
- may charge a monthly maintenance fee up to 7.5 percent of the loaned amount. The fee is fully earned on the first day of a month in which the loan has an outstanding balance;
- 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: (a) charge and collect a penalty of not more than 10 percent of the delinquent payment or payments or (b) declare the entire loan due and payable when a scheduled payment is ten 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.

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.

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 the participating in the business.

Consumer Protection Act.

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.

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.

Appropriation: None.

Fiscal Note: Available.

Effective Date: The bill takes effect 90 days after adjournment of the session in which the bill is passed.