

# HOUSE BILL REPORT

## HB 1922

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**As Reported by House Committee On:**  
Business & Financial Services

**Title:** An act relating to small loans and small consumer installment loans.

**Brief Description:** Addressing small loans and small consumer installment loans.

**Sponsors:** Representatives Springer, Lytton, Hurst, DeBolt, Rodne, S. Hunt, Kirby, Morris, Senn, Pettigrew, Blake, Clibborn, Takko, MacEwen, Harris, Stanford, Short, Vick, Parker, Wilcox, G. Hunt, Wylie, Pike, Moeller, Nealey, Hawkins, Johnson, Condotta, Walsh, Fagan, Buys, Kretz, Santos, Fey, Tarleton and Gregerson.

**Brief History:**

**Committee Activity:**

Business & Financial Services: 2/10/15, 2/11/15 [DPS].

**Brief Summary of Substitute Bill**

- Creates a new small consumer installment loan regulated by the Department of Financial Institutions.
- Permits a loan of up to \$1,000 for a minimum of six months and a maximum of 12 months.
- Allows an origination fee of 15 percent of the loaned amount, amortized over the life of the loan.
- 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 \$60 a month.
- Provides for a repayment plan prior to any civil action upon a loan in default.
- Makes military borrowers ineligible for a small consumer installment loan.
- Creates prohibited practices for licensees.
- Eliminates traditional payday loan product.

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**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:** The substitute bill be substituted therefor and the substitute bill do pass. Signed by 9 members: Representatives Kirby, Chair; Vick, Ranking Minority Member; Blake, G. Hunt, Hurst, Kochmar, McCabe, Santos and Stanford.

**Minority Report:** Do not pass. Signed by 1 member: Representative Ryu, Vice Chair.

**Staff:** David Rubenstein (786-7153).

## **Background:**

### Introduction.

A payday loan is a small cash advance made for very short periods for a fee proportional to the amount loaned. Generally, payday loans are secured by a post-dated check or funds transfer authorization to be deposited or executed on the date the loan becomes due (often on the borrower's next payday).

Payday loans are governed by a chapter also addressing check cashers, but several other statutes set up the framework for consumer lending in Washington.

### State Usury Rate.

State law prohibits interest rates exceeding 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 based on the United States Treasury bill rates. For many years, the applicable usury rate has been 12 percent per annum. A number of loan products and types of lenders are exempt from the usury rate.

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:

- 4 percent of the amount of funds advanced; or
- \$15.

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 licensed by the Department of Financial Institutions (Department) under the CLA may engage in the business of making secured or unsecured loans. An applicant for a license under the CLA must maintain a surety bond in an amount based on loan volume. The officers, directors, and owners of an applicant for a 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 also a per se violation of the Consumer Protection Act (CPA).

#### Loan Terms Under the CLA.

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

The Department oversees the CCSA. An applicant for a license under the CCSA must maintain a surety bond in an amount determined by the Department. As under the CLA, the officers, directors, and owners of an applicant for a 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 a small loans endorsement to their license. There are a variety of requirements for licensees under the CCSA, including record-keeping and reporting requirements. Like under the CLA, a check casher and seller 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.

Payday loans are required to have the following terms:

- The principal must not exceed \$700 to any one borrower at any one time across all lenders.
- The fee for the loan must not exceed 15 percent of the loaned amount for the first \$500, and not more than 10 percent on the amount over \$500.

- The minimum term of the loan is the borrower's next pay date, unless that is less than seven days, in which case it is the next following pay date.
- 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.

Licensees are prohibited from:

- making a payday loan to a borrower that is in default on a payday loan or that is in an installment plan; and
- 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.

The Department administers a database for licensees to ensure that the borrower is eligible for a loan and charges a fee to lenders to use the database. Lenders 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 for no penalty.

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 a payment plan. Payments in the plan 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, including prohibitions on harassing borrowers. 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 CPA to bring a private cause of action for damages, including damages up to three times the actual damages if approved by the court. The CPA also allows the Office of the Attorney General to bring an action in the name of the state or on behalf of consumers.

#### Financial Literacy and Education Programs.

The Department 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.

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**Summary of Substitute Bill:**

The small loans endorsement provisions in RCW 31.45 (CCSA) are repealed effective July 1, 2016, and payday loans are abolished.

Small Consumer Installment Loan Act.

The Small Consumer Installment Loan Act (SCILA) is a new subchapter in chapter 31.45 RCW. 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.

The existing check cashers and sellers' provisions, chapter 31.45 RCW, is separated into a subchapter. Check casher and seller licensees are permitted to sell open-loop prepaid access in retail installment transactions.

Applications and Licensure.

An applicant for a license must submit:

- an investigation and supervision fee established by the Department;
- fingerprints of each officer, director, and owner of the applicant for submission to the WSP or the FBI for a state and national criminal history background check; and
- evidence of a surety bond with a minimum value of \$30,000 and a maximum of \$250,000, based on the annual dollar amount of loans originated.

The Department must investigate an applicant to determine the financial responsibility, experience, character, and general fitness of the applicant. The Department may deny a license to those whose employees, officers, or directors have had felony convictions in the preceding seven years and must deny a license to applicants whose license was suspended or revoked under any similar statute in another state.

Once licensed, the licensee must pay an annual assessment fee.

Terms.

Small consumer installment loans are subject to the following limits:

<i>Maximum loaned amount:</i>	\$1,000
<i>Minimum term:</i>	6 months
<i>Maximum term:</i>	12 months

*Period between payments:* At least seven days

Small consumer installment loans may carry the following maximum interest and fees:

	<i>Term</i>	<i>Notes</i>
<i>Origination fee</i>	15 percent	Amortized through the loan term, accruing daily
<i>Annual interest</i>	36 percent	Amortized through the loan term, accruing daily
<i>Monthly maintenance fee</i>	7.5 percent, up to \$60 per month	Charged every month in which loan has unpaid balance on the last day of the month

The total principal loan amount must not exceed 30 percent of the borrower's gross monthly income. The licensee must verify the borrower's income using a pay stub at least every six months.

Additionally, a small consumer installment loan:

- must amortize all principal and fees over the term of the loan;
- must not be secured by a lien on any real property or personal property; and
- must be made primarily for personal, family, or household purposes.

If a borrower repays before the loan's maturity date, the borrower does not owe interest or origination fees that have not accrued and may not be charged a prepayment fee. However, the borrower must pay the monthly maintenance fee for each month in which the loan has an unpaid balance.

A licensee must not condition a small consumer installment loan on the borrower's repayment by preauthorized electronic fund transfers (EFTs) and a postdated check or preauthorized transfer must not be considered security for the loan. A number of different payment options may be offered to borrowers.

#### Loan Limit.

A borrower may have simultaneous installment loans at multiple lenders, provided the total amount of the loans do not exceed \$1,000 at any one time.

#### 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 signed 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 \$25 and/or an acceleration of the loan;
- 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 loan 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.

The lender may disburse proceeds by check, money order, prepaid card, EFT, or by other means allowed by rule.

#### 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 the borrower's statements on a standard form, adopted by rule, in determining if a borrower is ineligible.

#### 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.

#### Default and Repayment Plan.

If a borrower becomes delinquent for more than 10 days, the lender may charge a penalty of not more than \$25 and may declare the entire loan due and payable (accelerate the loan).

If the borrower defaults, the lender may take civil action and may also collect reasonable attorneys' fees, actual expenses, and costs incurred in collecting the amount owed. However, the lender may not engage in any communication with the borrower in such a way as to harass, intimidate, abuse, or embarrass the borrower. Communications are presumed harassment if they are made more than three times a week, made at the borrower's workplace more than once per week, or made between 9:00 p.m. and 7:30 a.m. Lenders must keep a log of all communications with the borrower. Lenders are also prohibited from threatening legal action they cannot legally take, visiting the borrower's home or workplace, and impersonating law enforcement.

Before bringing a civil action on a defaulted loan, the lender must offer the borrower a repayment plan. The offer must be open to the borrower for at least 15 days. The repayment plan must be for the defaulted amount and delinquency fees only and have the following terms:

<i>Minimum term:</i>	90 days
<i>Initial payment required:</i>	Up to 20 percent
<i>Additional interest and fees:</i>	Not allowed
<i>Collateral:</i>	Not allowed
<i>Insurance:</i>	Not allowed

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.

#### 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. If a dishonored check is transferred, the restriction on harassing communications applies to the party receiving the check.

#### 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 small consumer installment loan subchapter. Generally prohibited are unfair and deceptive practices, fraud, misrepresentation, failure to make required disclosures, false or deceptive statements, and omitting material facts. In addition to applicable penalties, any transaction that is 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.

#### Record-keeping.

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

#### Examination or Investigation.

The Department may examine and investigate any licensee or person who the Department has reason to believe is engaging in the business governed by the SCILA. The Department may examine any person under oath about a licensee's business or the subject matter of an



investigation. The Department may require the production of original books, accounts, records, and files or copies of such information. The Department 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 Department and any additional relevant information as the Department may require. Information provided by a licensee is exempt from public disclosure unless aggregated with other information in a manner such that individual information is not identifiable.

#### Sanctions.

The Department 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 small consumer installment loan subchapter;
- 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.

#### Consumer Protection Act.

A violation of the small consumer installment loan subchapter is a per se violation of the CPA.

#### Database.

The Department may adopt rules regarding a database system, including establishing fees for the use of the database and transfer of the existing system for payday loans to the new licensing program. The Department 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 Department to be used for financial literacy and education.

#### Rules.

The Department must adopt rules to implement and administer the SCILA. The director of the Department has broad administrative discretion in administering the act and effectuating its intent.

#### Adjustments for Inflation.

Beginning July 1, 2017, the Department must annually adjust the specified dollar amounts in the SCILA, including the maximum loan amount, the maximum monthly maintenance fee, and the late fee 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.

Report.

The Department must provide a report regarding small consumer installment loans by December 1, 2017. The report must contain various details of small consumer installment loans made in 2016.

**Substitute Bill Compared to Original Bill:**

The substitute bill provides that the monthly maintenance fee is only due when the borrower has an unpaid balance on the last day of the month. Also, the minimum period between payments is reduced from 14 days to seven days.

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**Appropriation:** None.

**Fiscal Note:** Available.

**Effective Date of Substitute Bill:** The bill takes effect 90 days after adjournment of the session in which the bill is passed, except for sections 1 through 16 relating to check cashers and sellers, which take effect July 1, 2016, or on and after the effective date of final rules adopted by the Director of Financial Institutions, whichever is later, provided sections 19 through 50 and 52 through 54 become law as enacted by the Legislature; and sections 19 through 54 relating to small consumer installment loans, which take effect July 1, 2016.

**Staff Summary of Public Testimony:**

(In support) National research has pointed to small consumer installment loans as a promising alternative to payday lending because the short-term repayment period is replaced with long-term amortization, the origination fee is rebated pro rata to the borrower for early repayment, and the loan amount is capped at \$1,000. The same research points to Colorado's law as the benchmark model for that kind of loan program, but Washington can do even better. Some argue that the current payday loan model is working well and should not be changed, but it is not working as well as it could.

(In support with concerns) This bill is good for consumers because it employs a reduced interest rate, longer terms, and, unlike Colorado, a database to enforce loan limits. The vast majority of borrowers in Colorado loans pay off their loans before they are due, and a shorter time to payoff reduces the annual percentage rate (APR) and fees. The concerns expressed by the Pew Charitable Trusts (Pew) ring hollow in light of Pew's own recent editorial in

*American Banker* encouraging the Consumer Financial Protection Bureau (CFPB) to model its rules after Colorado's law.

However, elements of this bill are problematic for lenders. The fact that no fees are earned at origination makes it difficult to cover costs in Colorado, and earned origination fees could offset those costs in Washington. Further, the 12-month repayment term is too short and the free repayment plan for defaulted loans is too burdensome for lenders. Expanded underwriting should also be included.

It is true that the CFPB is likely to promulgate rules to regulate payday and other small dollar loan products. However, those rules will not be in effect for at least a year. Until then, states should assert themselves in this area because they are better equipped to respond to the desires of their own electorates than any national organization.

(With concerns) Colorado's system is not as well regarded by state attorneys general as Washington's system is, though it is possible that the CFPB may incorporate some of Colorado's model. The underwriting requirements in this bill are lax and do not take into account many things that are usually considered before credit is offered. The protections offered to military members should be offered to the general public. Banks also face risk from payday loans and small consumer installment loans.

(Opposed) This bill is bad for consumers. Small consumer installment loans are equally as financially devastating as payday loans because they extend the length of the debt. There is no limitation on the number of loans a borrower may take, nor the frequency, both of which can saddle working families with long-term consequences. The APR on small consumer installment loans can exceed 200 percent. If this loan is too risky for military members, it is also too risky for the general public.

While 16 states have prohibited payday lending, Washington has adopted a model that is regarded nationwide as a success in keeping a balance between offering a short-term, high-cost product without banning it entirely. The current system should be retained and strengthened. Since reforms passed several years ago, housing stability has increased and the number of consumers needing assistance with payday debt has fallen. The reforms are working as intended; there is no need for a comprehensive change. If any alternative is offered, it should be market-based.

Pew released a letter explaining that this bill is harmful to consumers and that Washington already rates highly on consumer protection statistics for consumer lending. The CFPB is also expected to promulgate new rules on payday loans and it would be premature to implement a new program before that has happened.

Stakeholders have expressed that they are no longer as burdened by payday loans as they used to be, and they do not need a new product that is expensive and confusing. There are better opportunities to help consumers, such as with a compassionate budget and a higher minimum wage. Consumers should have a fair chance to escape payday lending, and policy can accomplish that without reforming the product.

**Persons Testifying:** (In support) Representative Springer, prime sponsor.

(In support with concerns) Dennis Bassford, Moneytree, Inc.; and Dennis Schaul, Community Financial Services Association of America.

(With concerns) David W. Huey, Office of the Attorney General.

(Opposed) Gordon McHenry, Solid Ground; Marcy Bowers, Statewide Poverty Action Network; Bruce Neas, Columbia Legal Services; Kira Zylstra, Financial Fitness Boot Camp; Rolando Avila; Joe Sky Tucker, Express Advantage Credit Union; and Eric Gonzalez, One America.

**Persons Signed In To Testify But Not Testifying:** None.