Fiscal Note & Local Impact Statement

127 th General Assembly of Ohio

Ohio Legislative Service Commission
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BILL: **Sub. H.B. 545** DATE: **April 30, 2008**

STATUS: **As Reported by House Financial Institutions** SPONSOR: **Rep. Widener**

LOCAL IMPACT STATEMENT REQUIRED: **No — Minimal cost**

CONTENTS: **Revises Ohio's consumer finance lending laws and makes other changes**

State Fiscal Highlights

STATE FUND	FY 2009	FY 2010	FUTURE YEARS
General Revenue Fund – Treasurer of State			
Revenues	- 0 -	- 0 -	- 0 -
Expenditures	Increase up to several hundred thousand dollars	Increase up to several hundred thousand dollars	Increase up to several hundred thousand dollars
Consumer Finance Fund (Fund 5530) – Department of Commerce			
Revenues	Potential loss from license fees	Potential loss from license fees	Potential loss from license fees
Expenditures	Increase of up to $792,000 for transfers; potential decrease in administrative costs	Increase of up to $267,000 for transfers; potential decrease in administrative costs	Increase of up to $267,000 annually; potential decrease in administrative costs
Financial Literacy Education Fund (New Fund) – Department of Commerce			
Revenues	Gain of up to $792,000	Gain of up to $267,000	Gain of up to $267,000 annually
Expenditures	Increase for program operation	Increase for program operation	Increase for program operation

Note: The state fiscal year is July 1 through June 30. For example, FY 2009 is July 1, 2008 – June 30, 2009.

Department of Commerce – Division of Financial Institutions

- ***Potential decrease in licenses*.** If, as a result of the bill's limits on origination fees and interest rates, check-cashers or check-casher lenders opt out of payday lending, license fee revenue to the Consumer Finance Fund (Fund 5530) would decrease. While it is uncertain how many check-cashers and check-casher lenders would opt out, the maximum revenue loss would be approximately $1.6 million annually, based on FY 2007 license fee data. However, if these licensees were to shift to another licensure category, such as to short-term or small loan companies, the potential net revenue loss would be reduced.

- ***Administrative costs*.** While the bill requires the Division of Financial Institutions (DFI) to examine the records of a licensee at least annually, which may increase the Division's administrative burden if current examinations are conducted less frequently, a significant loss in license fee revenue may lead to a reduction in administrative costs from issuing, renewing, and overseeing fewer licenses. Check-cashers and check-casher lenders make up about 22% of the active consumer finance licenses the Division of Financial Institutions (DFI) oversees. The magnitude of any effect will depend upon how licensed check-cashers and check-casher lenders respond to the requirements of the bill.

- ***Financial Literacy Education Fund*.** The bill creates the Financial Literacy Education Fund and allocates 5% of all charges, penalties, and forfeitures received by the Consumer Finance Fund (Fund 5530) to this new fund. Based on the revenue received in the last several years, the Financial Literacy Education Fund could expect to receive up to $267,000 annually. Based on the current balance in the Consumer Finance Fund, the one-time transfer of 5% would yield an additional $525,000 in FY 2009.

Treasurer of State

- ***Short-term installment loan linked deposit program*.** The creation of the Short-Term Installment Loan Linked Deposit Program would not have any impact on state revenues. However, the proposed linked deposit program creation and requirements may increase the Treasurer of State's expenditures from the GRF by approximately $325,000 annually. The creation of the new linked deposit program also requires an additional $20,000 one-time cost to set up a new database.

Local Fiscal Highlights

LOCAL GOVERNMENT	FY 2008	FY 2009	FUTURE YEARS
Counties and Municipalities			
Revenues	Potential minimal gain	Potential minimal gain	Potential minimal gain
Expenditures	Potential minimal increase	Potential minimal increase	Potential minimal increase

Note: For most local governments, the fiscal year is the calendar year. The school district fiscal year is July 1 through June 30.

- ***Civil justice considerations*.** Current law, mirrored by the bill, provides civil remedies that the Attorney General and the consumer may use to pursue violations committed by check-casher lenders through the Consumer Sales Practices Act (CSPA). While the bill contains new prohibitions and requirements on short-term lenders, very few payday lenders have been found to violate the law. In view of this and the potential of the bill to significantly decrease check-casher lender licensure activity, it is unlikely that the overall impact of the new prohibitions and requirements on local civil justice costs would be any more than minimal.

- ***Local criminal justice costs*.** In addition to the civil remedies available, the bill, mirroring current law, also imposes a first-degree misdemeanor (M1) criminal penalty for short-term lender violations. As a result of the new requirements, some additional persons could be prosecuted and sanctioned. This could, in turn, increase local criminal justice expenditures. It is uncertain how many cases will result from the new requirements and prohibitions created by the bill, but it appears that the number and any associated expenses are likely to be minimal. Some of these costs would be offset by court costs and fees assessed on violators.

Detailed Fiscal Analysis

Overview

This bill makes a number of changes to Ohio's lending laws, particularly those for so-called "payday loans." Specifically, the bill caps interest on a short-term loan at 28% per year, reduces the maximum short-term loan amount to $500, creates the Financial Literacy Education Fund, increases the license fee amounts for check-casher lenders that would seek short-term loan licenses, and creates a statewide database to determine the eligibility of borrowers. In addition, the bill creates a new small loan linked deposit program through the Treasurer of State (TOS) that would enable lending institutions to offer small loans to consumers through certificates of deposit placed by the Treasurer at up to 3% below current market rates.

Short-term loan licenses

***License fees*.** Currently, in order to originate what are commonly referred to as "payday loans" in Ohio, a check-casher lender must be licensed by the Superintendent of Financial Institutions. There is a two-tiered system of licensing for check-cashing businesses. A licensed check-casher may cash checks and pay their customers the full amount of the check less any charges permitted by law. In order to make loans, a check-cashing business must obtain a second license. Check-cashers and check-casher lenders pay a $500 license fee upon application for an initial license and a $500 annual renewal fee. Check-cashers and check-casher lenders also pay one-time investigation fees between $150 and $200.

The bill would no longer require a second license in order to make small, short-term loans. Rather, the bill would require only a single license. Short-term loan license applicants would be charged initial license and renewal fees of $1,000 for each business location along with a $200 one-time investigation fee. Nonprofit corporations that wish to make loans under the bill would pay half the original and renewal fees that a for-profit company pays. These fees are paid into the Consumer Finance Fund (Fund 5530). Short-term loan licensees are also to obtain and maintain a surety bond of at least $100,000, which would be for the exclusive benefit of a borrower injured by a violation of the bill's prohibitions.

***Loan terms*.** Current law requires the loans made by check-casher lenders to be made under a written contract, not to exceed $800, and not to have a duration of more than six months. Licensees are permitted to charge a loan origination fee and interest at not more than 5% per month or fraction of a month on the unpaid principal balance of the loan. Licensees may also charge check-collection fees in instances where a check has been dishonored or returned for insufficient funds.

The bill reduces the maximum loan amount to $500 and specifies a minimum loan term of at least 31 days. Short-term loan contracts must include a provision offering the borrower an extended payment plan at any time before the maturity date of the loan, which would allow the borrower at least an additional 60 days to pay off the loan.

The bill limits the interest (which would now include fees, service charges, renewal charges, credit insurance premiums, and so on) that may be charged on a payday loan to an annual percentage rate (APR) of 28%. This would translate to a maximum finance charge of approximately $2.38 on a 31-day $100 loan.[1] The table below illustrates how finance charges are calculated at various loan amounts both under current law and under the bill under a 31-day loan model.

Table 1: Payday Loan Finance Charge Crosswalk		
Loan Amount	**Current Law[2]**	**Proposed Changes in H.B. 545**
$500 or less	$5 loan origination fee for every $50 borrowed plus 5% interest per month or partial month	28% Annual Percentage Rate (includes all fees and charges other than check collection charges for bounced checks)
	Example of $100 loan for 14 days: $100 + $10 loan origination fee + $5 in interest = **$115 (APR = 391.07%)[3]**	**Example** of $100 loan for 31 days: $100 + $2.38 in finance charges = **$102.38**
	Example of $500 loan for 14 days: $500 + $50 loan origination fee + $25 interest = **$575 (APR = 391.07%)**	**Example** of $500 loan for 31 days: $500 + $11.90 in finance charges = **$511.90**
More than $500 but up to $800	5% interest + $5 loan origination fee for every $50 for the first $500 and $3.75 loan origination fee for every $50 above $500	N/A
	Example of $800 loan for 14 days: $800 + $72.50 ($50 for the first $500 and $22.50 for the last $300) in loan origination fees + $40 in interest = **$912.50 (APR = 366.63%)**	N/A

Much of the fiscal effect of the interest rate cap will depend on how the industry will react under the new guidelines and thus how many licensed check-casher lenders will stay in or enter the industry using the short-term loan license the bill creates and continue to pay license fees. That question may be addressed by examining the current operating costs and profits of payday lenders in view of the revised finance charges allowable under this bill, as well as reviewing the experience of other states that have experienced similar rate caps.

Current payday lender costs and profits**.** There is limited publicly available data in regard to payday lender operating costs and profits. An often-cited source is Flannery and Samolyk's 2005 working paper for the Federal Deposit Insurance Corporation's (FDIC) Center for Financial Research. Their study examined proprietary store-level data from two large payday lending firms to study store costs and profitability.[4] This study included data on a random sample of 600 stores operating in 22 states and found a relatively high average cost of originating payday loans. Specifically, Flannery and Samolyk found that average costs for a

[1] This is calculated by dividing the APR by the number of 31-day periods in one year to find the APR's 31-day equivalent. So, 0.28/(365/31) = ~ 0.0238, which would equate to an approximate interest rate of 2.38% for 31 days.
[2] Ohio Department of Commerce, Office of Consumer Affairs "Payday Loans" publication.
[3] The formula to calculate the APR is as follows: APR = [(advance fee/principal borrowed) x (365/14)] x 100. The advance fee is divided by the principal amount to obtain the cost of credit for the loan period. Under current law, for a $100 loan, the total advance fee is $15 and thus the cost of credit in this example, expressed as a percentage, is 15% or 0.15. We divide 365 by 14 to obtain the number of 14-day periods within a year and multiply that number by the interest rate for the loan period to annualize the cost of credit. The value of 365/14 is approximately 26.07. So, [(15/100) x (365/14)] x 100 = 391.07%.
[4] Flannery, Mark and Katherine Samolyk, "Payday Lending: Do the costs justify the price?" FDIC Center for Financial Research Working Paper 2005-09, June 2005.

store open at least one year to loan $100 were between $11 to $14, depending on the age of the store; these are figures the authors contend are not that out of line with the size of advance fees (the average advance fee in the study ranged from $14.32 to $18.30 depending on store age).

Flannery and Samolyk find the average store's operating margin (the ratio of operating income-to-store revenue which measures how much revenue is left over after store operating costs are deducted) to be 33.2%. However, this margin does not account for shared administrative (or "G&A") and interest expenses allocated by the payday lending firm at the corporate level, which, when accounted for, reduce true store profitability. The table below summarizes Flannery and Samolyk's findings for stores open at least one year. As the table demonstrates, the study found that older stores are more profitable due to greater loan activity. In sum, the study's authors concluded that fixed operating costs and high loan loss rates account for a large part of the high APR charged on payday advance loans.

Table 2: Payday Lending Industry Profitability

	Young Stores (1-4 years) Avg. Loan Size = $257.72		Mature Stores (>4 years old) Avg. Loan Size = $227.54	
	$ per loan	**$/$100 advanced**	**$ per loan**	**$/$100 advanced**
Avg. Total Store Revenue	$45.94	$17.83	$43.82	$19.26
Avg. Total Store Operating Costs	$36.10	$14.01	$25.10	$11.03
Avg. Store Operating Income	**$9.84**	**$3.82**	**$18.72**	**$8.23**
Avg. G&A and Interest Expenses	$12.84	$4.98	$7.47	$3.28
Avg. Pre-tax Store Income	**($3.00)**	**($1.16)**	**$11.26**	**$4.95**

Source: Flannery and Samolyk

Another source of information concerning the profitability of payday lenders comes from the quarterly Securities and Exchange Commission (SEC) filings of seven publicly traded payday lending companies (some of these companies also engage in pawn business). An August 2006 study in the Fordham Journal of Corporate and Financial Law reviewed these documents (which includes data from nearly 8,000 payday lending stores) and came to a similar conclusion as Flannery and Samolyk: that payday loan firms are not "overly profitable."[5] While average store operating margins were comparable to those reported by Flannery and Samolyk (24.64%), the average profit margin (the percentage of gross revenue that remains after subtracting out all associated costs for the period) was 7.63% when including companies that, while pawn is their primary business, also make payday loans. This study also noted that the average profit margin was less than Starbucks (a little over 9%), a company with a similar business-franchising model as firms in the payday lending industry.

Also among the findings was a contention that the industry's average profit margin is attributable to high operating costs, which are driven by longer business hours (leading to higher wage costs) and a large number of stores (leading to high occupancy or rent costs) that are needed to drive loan volume and thus profitability.[6] The high cost of loan losses also contribute heavily to a store's operating costs, further reducing profitability (around 25% of store operating

[5] Huckstep, Aaron, "Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?" Fordham Journal of Corporate and Financial Law, October 2006, Volume XII, pages 203-231.

[6] Flannery and Samolyk cite another study indicating a high concentration of storefronts is necessary in the payday lending industry since competition appears to revolve around customer convenience rather than price.

costs in both studies); however, the Fordham study indicated that loan losses for payday lenders are not unusual in comparison to commercial lenders.

Case studies. Recent experience of other states with similar payday lending rate caps may also inform what could happen in this state under similar circumstances. An August 2001 Indiana Supreme Court ruling limited payday loan finance charges to 72% APR by applying Indiana's loan-sharking law to payday lenders.[7] After this, the number of entities licensed and the number of branch locations decreased. According to Indiana Department of Financial Institutions (IDFI) annual reports, at the end of CY 2000, Indiana had 119 payday lender companies registered with 463 branch locations. By the end of CY 2003, there were 44 companies registered with 313 branch locations, amounting to a reduction in the number of companies and branch locations of 63.0% and 32.4%, respectively.

An IDFI official noted that most of the larger payday lending companies continued to operate under the 72% rate cap under the industry's expectation that a new law authorizing the practice with sufficient fees would be passed. This occurred in March 2002 through a bill that specifically provided for the existence of payday lending in Indiana after several disputes (including the Indiana Supreme Court case above) about the issue of payday lending in that state. The March 2002 law limited payday loans to $401 and the associated finance charge to $35. This law was updated in July 2004 to revise the allowable finance charges according to a scale that reduced the percentage charged on the loan as the principal amount increased. By the end of CY 2005, the number of companies and branch locations increased to 54 and 547, respectively.

Another more recent example comes from Oregon, which, effective July 1, 2007, changed its payday lending laws to limit origination fees to $10 per $100 advanced (in other words, a 10% origination fee) and interest to 36% APR. The minimum loan term is 31 days. Including the origination fees yields an APR of 153% for a 31-day loan. An LSC review of recent SEC filings by the publicly traded payday lending companies indicated that, in some cases, these firms cited the new law's origination fee and interest caps as reasons for closing some or all of their payday loan outlets in Oregon. Advance America, the country's largest payday cash advance company, is closing all 45 of its stores in Oregon. QC Holdings has already closed all eight of its stores, and First Cash Financial Services has closed two of its seven stores in the state.

Impact on license fee revenue. Given the recent industry experience in Indiana and Oregon, it seems reasonable to assume that some check-casher lenders licensed in Ohio might choose not to continue business in the state using the short-term loan license. If so, license fee revenue to the Consumer Finance Fund (Fund 5530) from short-term lenders and check-cashers would decrease. As of April 29, 2008, the Department of Commerce's Division of Financial Institution's license roster listed 1,572 check-casher lender licenses and 1,675 check-casher licenses in Ohio (for a total of 3,247 licenses).[8]

While it is uncertain how many check-cashers and check-casher lenders would discontinue operations, if a significant portion were to do so, the Consumer Finance Fund (Fund 5530) could experience a loss in revenue in the hundreds of thousands of dollars, and perhaps

[7] Janet Livingston, et al. v. Fast Cash USA, Inc., Case Number 94S00-0010-CQ-609.
[8] Accessed through the Ohio eLicense Center at http://www.com.state.oh.us/dfi/elicense.aspx.

over $1 million if the vast majority were to leave the industry in Ohio. Revenue from license fees from check-cashers and check-casher lenders was approximately $1.6 million in FY 2007.

However, as the growth in the payday lending industry would seem to show, there is a high demand for the short-term, small dollar loan products these businesses provide. If the interest rate caps in the bill make payday lending in its current form an unprofitable venture, Ohio licensees may instead develop alternative, short-term loan products in some way to remain profitable while keeping a check-casher/short-term lender license.

Other industry operators might simply seek licensure under another licensure category, such as Ohio's Small Loan Act, which allows lenders to offer higher principal loan products, including open-ended lines of credit. Small loan licensees pay license fees of $300 into the Consumer Finance Fund. To the degree that an increase in small loan licensure occurs, this might limit potential revenue losses to this fund.

***Administrative costs*.** The Division of Financial Institutions (DFI) in the Department of Commerce oversees the administrative work of approximately 15,000 active consumer finance licenses with check-cashers and check-casher lenders comprising about 22% of that amount. DFI's Consumer Finance program, which currently employs 39 people, also regulates other consumer finance occupations and companies such as mortgage brokers, loan officers, second mortgage companies, and small loan companies. None of these employees work exclusively on check-casher or check-casher lender issues. Rather, DFI assigns these employees by function. So, field examiners perform examinations of mortgage brokers, check-cashers/check-casher lenders, pawnbrokers and so forth, while licensing staff work on all license types.

Current law only requires DFI to examine the records of check-cashing lenders as often as DFI considers necessary. The bill requires DFI to examine the records of a licensee at least annually, which may increase the administrative burden on DFI if current examinations are conducted less frequently. The increased license fee that check-casher lenders/short-term lenders would pay would offset any cost increases. However, if a significant number of licensees were to allow their licenses to lapse, payroll and other costs from the Consumer Finance Fund (Fund 5530) and the Financial Institutions Fund (Fund 4X20), which also pays for a portion of the Consumer Finance program, may decrease due to a reduction in licenses to oversee. The magnitude of any effect will depend upon how licensed check-cashers and check-casher lenders respond to the requirements of the bill.

***Remote payday lender prohibitions*.** The bill prohibits licensees from making short-term loans when the borrower is not physically in the lender's place of business and prohibits any person from making, offering, or brokering a loan, or assisting a borrower in obtaining a loan via the telephone, mail, or internet. Based on a review of DFI's check-casher lender license roster, there are several out-of-state Internet payday lenders currently licensed in Ohio. As a result, a minimal amount of annual license fee revenue will be lost.

Financial Literacy Education Fund

The bill creates the Financial Literacy Education Fund to support various adult financial literacy education programs developed or implemented by the Director of Commerce. At least half of the programs must be presented or made available at public community colleges or state institutions throughout the state. An annual report is required to outline the programs developed, the number of people educated by each program and an accounting of the funds distributed.

The bill directs the Director of Budget and Management to make a one-time transfer of 5% of the balance of the Consumer Finance Fund (Fund 5530) to this new fund. As of this writing, there is a cash balance of approximately $10.5 million in Fund 5530. Allocating 5% of this amount would provide approximately $525,000 for the Financial Literacy Education Fund in FY 2009.

In addition to this one-time transfer, the bill provides an ongoing revenue source for the Financial Literacy Education Fund: 5% of all charges, penalties and forfeitures received by the Fund 5530. This amount is to be transferred on, at least, a quarterly basis. Annual revenue to Fund 5530 averaged approximately $5.34 million from FY 2004 to FY 2007. Assuming "charges" would include all fees received by Fund 5530 and revenue is comparable to prior years, annual transfers to the Financial Literacy Education Fund would amount to approximately $267,000. However, if a significant reduction in check-casher lender/short-term lender licensure occurs as a result of the bill, this amount would be smaller.

Short-term installment loan linked deposit program – Treasurer of State

The bill authorizes the Office of the State Treasurer to establish a Short-Term Installment Loan Linked Deposit Program for the purposes of providing short-term installment loans to eligible individuals. These short-term installment loans are not to exceed a principal amount of $800 and must have a duration of at least 90 days and six installments. The APR on these loans is not to exceed 28%. The bill also indicates lenders' responsibilities.

Under the proposed Short-Term Installment Loan Linked Deposit Program, an eligible lending institution may enter into a deposit agreement with the Treasurer of State. Subsequently, if its short-term installment loan linked deposit loan package is approved, the public depository will receive a linked deposit in the form of a certificate of deposit (CD) at up to 3% below current market rates.[9] In return for the reduced interest earnings on the state's certificates of deposit, the eligible lending institution makes short-term installment loans to eligible individuals. The bill specifies that the State Treasurer must develop guidelines necessary to implement the new Short-Term Installment Loan Linked Deposit Program.

The Treasurer of State is also required to produce an annual report on the Short-Term Installment Loan Linked Deposit Program to be submitted to the Governor, Speaker of the House of Representatives, and President of the Senate. The report must set forth the linked deposits made by the Treasurer during the year, the number of short-term installment loans made by each institution, categorized by postal zip code, and a representation of the number or percentage of loans pursuant to the program that were paid late or are in default. Essentially, the bill extends current annual report requirements on established linked deposit programs to the Short-Term Installment Loan Linked Deposit Program.

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[9] Current linked deposit programs require the same rates. Hence, the amount of interest earnings that the state would give up on the CDs under the bill, in exchange for savings to the eligible lending institutions that provide small loans at a lower interest rate for the Short-Term Installment Loan Linked Deposit Program participants, would also remain the same.

The bill also authorizes the state Treasurer to use state funds to purchase certificates of deposit equaling the total amount of money lent by eligible lending institution to the individuals participating in the Short-Term Installment Loan Linked Deposit Program.

In general, the bill creates a new category of linked deposit program, but does not change the current interest rate requirements on the CDs for linked deposit programs or the current aggregate percentage of state funds that the State Treasurer may invest in all linked deposit programs. Therefore, the creation of the Short-Term Installment Loan Linked Deposit Program would not have any impact on the state's earnings on investments and revenues. However, the Treasurer of State's expenditures would increase by approximately $345,000 annually. According to the Treasurer's office, its expenditures would increase by $200,000 for salaries and benefits to hire three additional employees for monitoring and reporting of the new linked deposit program, $25,000 in marketing fees, and $100,000 increase in annual banking fees.[10] In addition, there will be a one-time cost of about $20,000 to set up a new database to implement the new program.

Criminal background checks

The bill requires both state and national criminal background checks for individuals applying for a short-term loan license. The Bureau of Criminal Identification and Investigation (BCII) in the Office of the Attorney General charges $46 to perform both a state and federal criminal records check. The applicant pays the fee. The Division of Financial Institutions currently requires applicants for check-casher lender licenses to obtain criminal background checks as part of the application process. If there were fewer consumer finance licensees, BCII may perform fewer criminal records checks. While this would decrease expenses in performing the records checks, there would be a corresponding reduction in fee revenue to the General Reimbursement Fund (Fund 1060).

Statewide consumer eligibility database

The bill requires DFI to make available a statewide database accessible to short-term lenders to determine a borrower's eligibility for a short-term loan. The bill does not permit short-term lenders to charge consumers any part of this fee, which is payable to the database operator (which can be either the Superintendent of Financial Institutions or a third-party) for the actual costs of entering, accessing, and maintaining data in the database. DFI would likely require a third-party to set up and operate the database.

Other states such as Michigan, Indiana, Oklahoma, Illinois, and Florida have implemented similar borrower eligibility databases with database fees being between $0.43 and $1.00 per transaction.[11] Assuming Ohio contracts with a vendor such as Veritec (which currently offers statewide eligibility databases to the above states) to provide the database, DFI would incur no "hard" cost for the database since the vendor would be compensated through the transaction fees paid by consumers. Yet, there would likely be some intangible costs related to

[10] Assuming 10,000 individuals participate in the new linked deposit program. Costs per person are estimated at $10.

[11] Florida and Oklahoma receive a portion of the fee to pay for regulatory efforts and consumer credit counseling, respectively.

working with the vendor to set up and maintain the database, resolving any database issues, and so forth.

Consumer Finance Education Board

The bill expands the authority of the Consumer Finance Education Board to include the analysis and investigation of the policies and practices of state agencies, nonprofit entities and businesses inasmuch as those policies and practices address small loan counseling and education for borrowers. The bill also allows the Board to coordinate and provide resources to state agencies, nonprofit entities, and businesses to improve small loan counseling and education for borrowers in addition to the other areas that the Board can coordinate and provide resources to under current law. As of this writing, original appointments to the Board have not yet been completed and the Board has not met. However, the expansion of the Board's duties may increase the Board's costs over what they would have been absent the bill's enactment.

Alternative lending options

Current law allows banks to set finance charges at any rates agreed upon by the parties to a loan contract, extension of credit, or revolving credit agreement, up to an APR of 25%. Under the bill, banks are specifically authorized to lend under the short-term installment loan linked deposit program, which has an APR cap of 28%. The bill would also allow savings and loan associations and credit unions to make unsecured loans that meet the criteria of the new short-term loans under the bill, which also allow for an APR of up to 28%. Under the bill, these establishments would not require an additional short-term lending license as the Division of Financial Institutions already regulates them.

Local fiscal effects

Current law, mirrored by the bill, provides civil remedies that the Attorney General and the consumer may use to pursue violations committed by short-term lenders through the Consumer Sales Practices Act (CSPA). While the bill contains new prohibitions and requirements on short-term lenders (including new prohibitions on debt collections practices), a review of DFI enforcement actions since August 2006 indicates that very few payday lenders have been found to violate the law. According to the Department of Commerce, most violations are minor and are immediately corrected or are handled through DFI enforcement actions, with the Attorney General's office rarely involved in payday lender violations.

The bill also permits borrowers to bring a civil action for recovery of damages against a short-term loan licensee if the licensee does not abide by certain duties and standards of care. Damages awarded may not be less than all compensation paid directly or indirectly to a licensee from any source, plus reasonable attorney's fees and court costs. In addition, the borrower may be awarded punitive damages. In view of this and the potential of the bill to significantly decrease check-casher lender licensure, it is unlikely that the overall fiscal impact of the new prohibitions and requirements on local civil justice operations would be any more than minimal.

In addition to the civil remedies available, the bill (mirroring current law) also imposes a first-degree misdemeanor (M1) criminal penalty for violations, carrying a maximum jail term of 180 days and a maximum fine of $1,000. As a result of the new requirements and prohibitions in the bill, some persons who may not have been successfully prosecuted and convicted under existing law could be prosecuted and sanctioned. This could in turn increase local criminal justice expenditures. By the same token, local fine and court cost revenue may increase, offsetting some or all of any additional criminal justice costs. If additional criminal cases are created, there is also the possibility that the state may gain a negligible amount of state court cost revenue to the GRF and the Victims of Crime/Reparations Fund (Fund 4020). For misdemeanors, the GRF receives $15 per case and the Victims of Crime/Reparations Fund (Fund 4020) receives $9 per case.

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