



Ohio Legislative Service Commission

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Fiscal Note & Local Impact Statement

Bill: [H.B. 486 of the 128th G.A.](#)

Date: April 27, 2010

Status: As Introduced

Sponsor: Reps. Lundy and Stebelton

Local Impact Statement Procedure Required: No — No local cost

Contents: Establishes certain consumer protections concerning small loans

State Fiscal Highlights

- Lenders that offer short-term consumer loans are regulated by the Division of Financial Institutions within the Department of Commerce. Because the bill places limits on the fees that these lenders may charge on their loan products, some lenders might leave the loan market in Ohio altogether. If so, license revenue deposited into the Consumer Finance Fund (Fund 5530) could decline significantly.
- Fund 5530 is used to support the Division of Financial Institutions' compliance, examination, and enforcement activities related to the consumer finance business, including short-term consumer loans. The fund also supports consumer outreach, complaint intake, and other services. If licensing receipts decline significantly, it would require the Division to make adjustments in these areas.
- The bill contains new criminal penalties that apply to illegal consumer lending practices. If additional prosecutions and convictions occur as a result, the Indigent Defense Support Fund (Fund 5DY0) and the Victims of Crime/Reparations Fund (Fund 4020) would receive a portion of the locally collected court costs.

Detailed Fiscal Analysis

Background

The bill establishes several new restrictions regarding short-term consumer loans offered by business that are licensed by the Division of Financial Institutions within the Department of Commerce. These changes are in addition to those in H.B. 545, which eliminated the check-casher lender license, created a short-term loan license, and limited the interest on loans issued under that license to an annual percentage rate (APR) of 28%. As Table 1 below shows, the H.B. 545 changes, which became effective September 1, 2008, altered the consumer loan business and licensure activity in Ohio significantly. Note that the actual number of business locations offering these consumer finance products is lower due to lenders that maintain licenses under more than one lending or license statute.

| License Type | June 30, 2008 | April 26, 2010 | Change |
|-----------------------------|----------------------|-----------------------|----------------|
| Check-casher | 1,680 | 992 | (688) |
| Check-casher Lender | 1,577 | N/A | (1,577) |
| Mortgage Loan Act Lender | 1,175 | 1,589 | 414 |
| Pawnbroker | 166 | 292 | 126 |
| Precious Metal Dealer | 23 | 105 | 82 |
| Credit Service Organization | 15 | 28 | 13 |
| Small Loan Act Lender | 11 | 515 | 504 |
| Short-term Loan | N/A | 0 | 0 |
| Total | 4,647 | 3,521 | (1,126) |

As can be seen in the table, one major change is that operators formerly licensed as check-casher lenders have moved to licensure under the Small Loan Act (SLA) and the Ohio Mortgage Loan Act (OMLA). According to a September 2009 estimate from the Division of Financial Institutions, there are approximately 835 former check-casher lender locations that have done so. Depending on the law that the lender is operating under, these alternate lending statutes permit APRs of between 25% and 28% and a sliding scale of origination fees based on the size of the loan. Despite the lower allowable fees and APRs, many of the former check-casher lenders have been able to stay in business under the SLA and OMLA by issuing loans by check and offering to cash these checks for a fee.

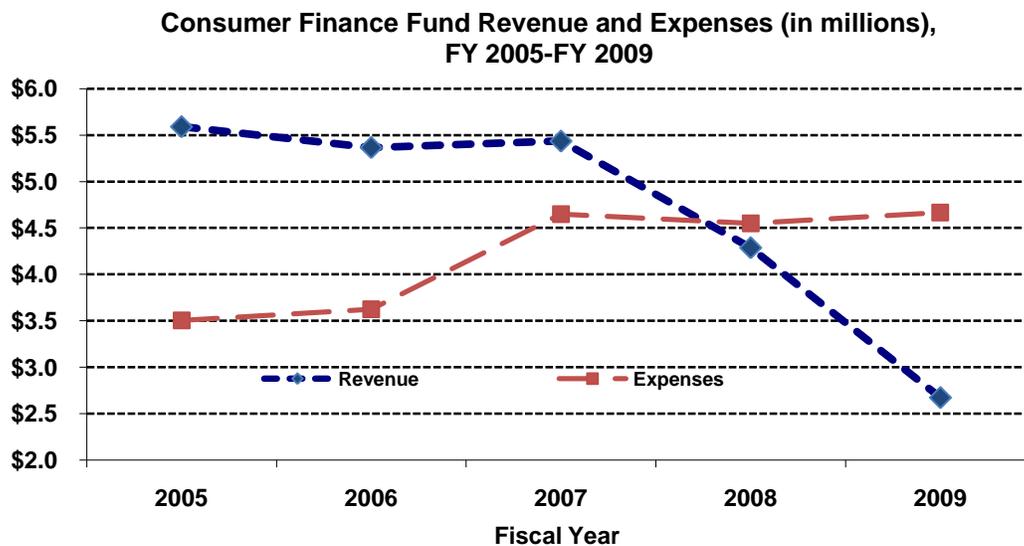
In response, the bill prohibits lenders covered by the SLA or OMLA from charging various fees. This includes (1) loan origination or credit investigation fees charged more than once per any 90-day period on loans of \$1,000 or less, (2) fees to cash checks issued to fund a loan, and (3) any fees assessed by a credit service organization

(CSO). The bill also increases the range of fines for certain violations of the SLA and OMLA and creates new penalties for violating the fee limits in the bill. The fiscal effects of these provisions on the Division of Financial Institutions are discussed below. This is followed by a section that discusses recent research on changes in short-term consumer loan regulations in other states and the impact of these changes on the industry in those states.

Fiscal effect on the Division of Financial Institutions

Depending on the response of lenders to the changes in the bill, the bill could lead to a loss of license fee revenue collected by the Division of Financial Institutions and deposited into the Consumer Finance Fund (Fund 5530). Lenders that currently charge fees prohibited by the bill will have to alter their business plans, possibly to operate under some other license. If they cannot remain profitable under these changes, it is reasonable to assume that some, if not many, SLA and OMLA lenders, particularly the former check-casher lenders that migrated to those licenses, might cease business in the state altogether. Although the amount of any revenue loss would depend on the number of lenders that would decide to leave the state, the 835 former check-casher lender storefronts currently operating under a different license represent about \$250,000 in annual renewal fees (835 X \$300 = \$250,500). The loss would be greater if these lenders maintain multiple consumer finance licenses.

Consumer Finance Fund (Fund 5530) revenue has been in decline since FY 2007. This is primarily due to statutory changes addressing predatory lending (S.B. 185 of the 126th General Assembly) and payday lending practices (H.B. 545), which caused some operators to cease operations in Ohio. At the same time, there has been an increase in licensing and enforcement costs in other businesses regulated by the Division of Consumer Finance, particularly the mortgage lending industry. The chart below illustrates the revenue and expense history (excluding transfers) for the Consumer Finance Fund over the last five fiscal years. Through March of FY 2010, expenditures for the fiscal year have exceeded revenues by approximately \$1.4 million.



The Division of Financial Institutions oversees approximately 8,100 active consumer finance licenses, with SLA and OMLA lenders comprising about one-fourth of that number. None of the employees within the Division works exclusively on SLA and OMLA issues. Rather, these employees are assigned by function. For example, field examiners perform examinations of mortgage brokers, SLA lenders, pawnbrokers and so forth, while licensing staff work on all license types. Because of the decline in Consumer Finance Fund revenue mentioned above, the Division began a staff restructuring of the Consumer Finance program in FY 2008 to improve efficiency while maintaining its compliance, examination and enforcement responsibilities. As a result of the changes, the number of employees in the Consumer Finance program has declined from 38 in FY 2008 to 26 at the end of calendar year (CY) 2009. If the bill causes a further drop in license revenue, the Division would be required to make further adjustments in its compliance, examination, and enforcement activities. A decline in revenue would also affect consumer outreach, complaint intake, and other services paid for by Fund 5530.

New penalties and increased fines

The bill creates several new penalties for violations of consumer lending statutes. Many of the new penalties in the bill are minor misdemeanors. These penalties are punishable only by a fine, do not require the offender to be arrested, and cost little to process. This means that they could generate some small amount of new revenue for the counties where the offenses occur. In addition, the bill increases the range of fines associated with violations of certain existing prohibitions of the Ohio Mortgage Loan Act. Under current law, the fine for these activities ranges from \$100 to \$500. Under the bill, the fine could range from \$500 to \$1,000, creating the potential for additional fine revenue for the county where the applicable trial court is located. At the state level, the Indigent Defense Support Fund (Fund 5DY0) and the Victims of Crime/Reparations Fund (Fund 4020) may experience a minimal gain in locally collected state court cost revenue. For misdemeanors, Fund 5DY0 receives \$20 per case while Fund 4020 receives \$9 per case. The new offenses created by the bill, as well as the penalties and sanctions associated with them, are shown in Table 2 below.

Table 2: New Criminal Penalties Associated with Consumer Lending

| Offense | ORC Reference | Penalty | Possible Prison Term | Possible fine |
|--|--|--------------------------|-----------------------------|----------------------|
| Charging or receiving any fees assessed by a registered credit services organization under the Small Loan Act | 1321.13(G); 1321.99(B) | Unclassified misdemeanor | 6 months | \$100-\$500 |
| Willfully charging or receiving any fees assessed by a registered credit services organization under the Ohio Mortgage Loan Act | 1321.57(H); 1321.99(D) | Minor misdemeanor | N/A | \$500-\$1,000 |
| Knowingly inducing or permitting any person to be obligated under more than one loan at the same time to obtain a higher rate of interest or greater charges than otherwise permitted (existing prohibition) | 1321.15(A); 1321.99(D) | Minor misdemeanor | N/A | \$500-\$1,000 |
| Charging, contracting for, or receiving interest and charges greater than permitted without a Small Loan Act license on any part of an indebtedness for one or more than one loan if the amount of such indebtedness is more than \$5,000 (existing prohibition) | 1321.15(B); 1321.99(D) | Minor misdemeanor | N/A | \$500-\$1,000 |
| Willfully charging a person a loan origination fee (or a credit investigation fee under the Ohio Mortgage Loan Act) more than once per any 90-day period on loans of \$1,000 or less under the Small Loan Act and Ohio Mortgage Loan Act | 1321.15(C); 1321.59(P); 1321.99(D) | Minor misdemeanor | N/A | \$500-\$1,000 |
| Under the Small Loan Act or Ohio Mortgage Loan Act: (1) charging or receiving a fee for cashing a proceeds check or money order that was disbursed to fund a loan; (2) requiring a borrower to cash such a check or money order at their business, at an affiliate, or at any specified third party; (3) seeking or obtaining compensation from any affiliate or third party that provides check-cashing services to cash a proceeds check or money order disbursed to fund a loan | 1321.15(D); 1321.59(Q); 1321.99(D) | Minor misdemeanor | N/A | \$500-\$1,000 |

Appendix

Short-term loan regulation in other states

As noted above, the limits on loan fees contained in the bill are likely to have a substantial impact on the business operations of short-term consumer lenders in Ohio. This finding is based on a review of selected data on the factors affecting industry profitability, consumer usage patterns of such loan products, and the reaction of some payday lending companies in the wake of recent reform laws enacted in other states, notably the state of Washington. The following provides a brief overview of this information.

Research on the small dollar, short-term lending industry indicates that a store's loan volume is a key factor in determining profitability. A 2005 study prepared for the Federal Deposit Insurance Corporation (FDIC) found that, in order to remain profitable, small dollar, short-term lending firms must maximize the number of loans made from each store.¹ High loan volumes are needed to offset the industry's higher relative operating costs. This is because competition in the short-term loan industry appears to be based primarily on convenience rather than price. That is, short-term loan businesses must have a high density of stores and longer business hours in order to effectively attract customers.² Research also indicates that a subset of the industry's customers use short-term loans frequently. This means that high-frequency borrowers will necessarily account for a disproportionate share of a lender's loan volume and profits. Thus, limiting the number of loans that a lender may make to a customer to four annually, the practical effect of H.B. 486, suggests that the bill will have a significant effect on the small loan business in Ohio.

Consumer usage statistics

The Ohio Department of Commerce does not keep borrower usage statistics for the former check-casher lenders nor for SLA and OMLA lenders, thus there are no publicly available figures describing the effects of H.B. 545 on consumer usage of small dollar, short-term loans in this state. However, 11 states require databases to determine eligibility for short-term consumer loan products. Reports tracking loan activity and other various statistics produced from these databases are publicly available for five of them: Florida, Illinois, Michigan, Oklahoma, and Virginia. Washington State has also collected similar statistics from payday lenders. Table 3 below summarizes several measures of consumer usage that are compiled and reported in these six states. Ohio's former check-casher lender law was similar to the laws in place in the states identified

¹ Flannery, Mark and Katherine Samolyk, "Payday Lending: Do the costs justify the price?" FDIC Center for Financial Research Working Paper 2005-09, June 2005, pg. 2, 9.

² 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.

below that have a greater level of high frequency borrowers, indicating that Ohio borrower activity under the former law was likely comparable.

| State | Reporting Period | Average Loans per Customer During Reporting Period | Share of Customers With > Four Loans Per Year | Share of Transactions by Customers With > Four Loans Per Year |
|------------|------------------|--|---|---|
| Oklahoma | 4/2008 – 3/2009 | 9.3 | 66.5% | 92.0% |
| Florida | 6/2008 – 5/2009 | 8.4 | 62.3% | 90.5% |
| Michigan | 6/2006 – 6/2007 | 8.3 | 66.1% | 94.0% |
| Washington | 1/2008 – 12/2008 | 6.9 | 52.6% | 85.5% |
| Illinois | 2/2006 – 12/2008 | 4.0 | 13.1% | 45.1% |
| Virginia | 1/2009 – 12/2009 | 2.7 | 22.1% | 46.2% |

The average borrower in four of these states took out more than the four loans per year that any particular lender could make to a borrower in a one-year period under the bill and still charge the applicable fees. In practical terms, although the bill limits a lender from making a loan to a borrower more than four times per year, a borrower could take out more than four loans per year if he or she used multiple lending companies. Although this is possible, data from four states suggest that consumers tend to patronize a single company when seeking short-term loans. Table 4 summarizes the data on provider usage included in eligibility database reports in four states. Also included in the table are data from a May/June 2007 survey of 1,173 payday loan customers, which included a question about the number of companies the customer patronized in the past twelve months.³

| State/Data Source | Reporting Period | % of Customers Using One Company | % of Customers Using Two Companies | % of Customers Using > Two Companies |
|-------------------|------------------|----------------------------------|------------------------------------|--------------------------------------|
| Virginia | 1/2009 – 12/2009 | 92.5% | 7.1% | 0.4% |
| Florida | 6/2008 – 5/2009 | 89.2% | 10.3% | 0.5% |
| Oklahoma | 4/2008 – 3/2009 | 69.1% | 26.7% | 4.2% |
| Illinois | 2/2006 – 12/2008 | 81.0% | 15.4% | 3.6% |
| Consumer Survey | 2006 – 2007 | 59.6% | 21.0% | 19.5% |

The figures in Tables 3 and 4 are generally consistent with the borrowing patterns listed in the most recent 10-K annual report that Advance America, Cash Advance Centers, Inc., the country's largest nonbank provider of cash advance services

³ Elliehausen, Gregory, "An Analysis of Consumers' Use of Payday Loans." The George Washington University School of Business Financial Services Research Program, Monograph No. 41, January 2009, pg. 45-46. Please note that this project was supported in part by a grant from the Community Financial Services Association of America, an industry trade association.

based on the number of locations, filed with the Securities and Exchange Commission. The firm operates in 32 states, including Ohio, and originated 10.9 million loans in CY 2009 to 1.3 million customers, which averages to approximately 8.3 loans per customer. Taken as a whole, these data suggest that short-term consumer lenders in Ohio would find it difficult to remain viable under the four loan per-lender per-year limit included in H.B. 486.

Effect of reforms in other states on payday loan activity/profits

The lower loan usage data for Virginia and Illinois shown in Table 2 appear to be driven by recent reforms to the payday lending laws in those states. However, as in Ohio, a portion of the small dollar, short-term loan industry in those states shifted to alternative forms of licensure or modified their business models in an effort to continue operating. Thus, the figures cited above likely understate borrower usage of such loan products in those states. The following is a brief discussion of the reforms in Illinois and Virginia, as well as the state of Washington, and the effect of these changes on the short-term loan industry in those states.

Under reforms which took effect in December 2005, Illinois prevents borrowers from having more than two loans at a time and prohibits borrowers from having a payday loan for more than 45 days. Once that time limit is reached, there is a seven-day loan free period. A 56-day repayment period is available at no additional cost for borrowers having trouble repaying the loans. In terms of fees, lenders may not charge more than \$15.50 per \$100 advanced while loan amounts are limited to the lesser of \$1,000 or 25% of a customer's gross monthly salary. Over the roughly three-year period from February 2006 to December 2008, the average borrower took out only four payday loans. In an effort to continue operating, many Illinois lenders began offering small dollar installment loans with longer repayment periods, though these loans are significantly less regulated than payday loans.⁴ As of January 2010, the state's Division of Financial Institutions reported 1,404 locations operating under the state's Consumer Installment Loan Act while just 438 locations operated under the reformed payday loan law.

Virginia changed its lending laws in January 2009 to increase the permissible loan fees, limit borrowers to one loan at a time, and provide two pay periods for repayment. Borrowers taking out five loans in six months are subject to (1) a cooling off period of two months or (2) must enter an extended payment plan of the same length followed by a cooling off period of three months. As a result of these changes, the number of payday loans dropped significantly, from 3.4 million in CY 2008 to approximately 460,000 in CY 2009. The average number of payday loans per borrower declined from 7.7 to 2.7 during that span. Over the same time, the number of payday

⁴"Payday loan loophole swallows borrowers whole." Chicago Tribune, May 12, 2008. <<http://www.chicagotribune.com/news/nationworld/chi-mon-payday-borrowers-may12,0,2679387.story>>. Accessed April 21, 2010.

lending firms dropped from 84 at the end of CY 2007 to 48 at the end of CY 2009. However, some lenders altered their business model to offer open ended lines of credit or car title loans.⁵

The State of Washington's payday lending law reforms, which took effect in January 2010, permit eight loans in a 12-month period while authorizing an installment payment plan at no additional cost for those having trouble repaying. Loans are limited to the lesser of \$700 or 30% of gross monthly income. Lenders may charge interest and fees totaling up to 15% on the first \$500 loaned and up to 10% on the amount over \$500. In recent SEC filings, Advance America reported that it expects revenues and profits to be significantly reduced because of this change and indicated it may cease to do business in the state entirely if it is unable to operate profitably. QC Holdings, another publicly held payday lending company, also stated in its most recent annual filing with the SEC that the regulatory changes in the state will adversely affect the revenues and profitability of its locations there. According to news reports, other lending firms indicated in December 2009 that they would cease operations in the state or evaluate the circumstances when leases come due for renewal.⁶

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⁵"Major payday lender is leaving Virginia." Richmond Times-Dispatch, April 23, 2009. <http://www2.timesdispatch.com/rtd/news/state_regional/state_regional_govtpolitics/article/PDAY23_20090422-221816/263015/>. Accessed April 21, 2010.

⁶ "Some lenders closing shop amid restrictions." Spokane Spokesman-Review, December 6, 2009. <<http://www.spokesman.com/stories/2009/dec/06/borrowed-time/>>. Accessed April 21, 2010.