

SENATE BILL REPORT

ESSB 5899

As Passed Senate, March 10, 2015

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

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

Sponsors: Senate Committee on Financial Institutions & Insurance (originally sponsored by Senators Liias, Keiser, Angel, Hobbs, Sheldon, Fain, Rivers, Roach, King, Ericksen and Honeyford).

Brief History:

Committee Activity: Financial Institutions & Insurance: 2/19/15 [DPS, DNP].
Passed Senate: 3/10/15, 30-18.

SENATE COMMITTEE ON FINANCIAL INSTITUTIONS & INSURANCE

Majority Report: That Substitute Senate Bill No. 5899 be substituted therefor, and the substitute bill do pass.

Signed by Senators Benton, Chair; Angel, Vice Chair; Fain, Hobbs, Litzow and Roach.

Minority Report: Do not pass.

Signed by Senators Mullet, Ranking Minority Member; Darneille and Pedersen.

Staff: Shani Bauer (786-7468)

Background: One type of loan product offered in Washington and regulated by the Department of Financial Institutions (Department) under the Check Cashers and Sellers Act (Act) is a small loan, commonly referred to as a payday loan. A business is authorized to provide this product by receiving an endorsement to a license issued by the Department.

Payday loans are a type of short-term, unsecured loan typically offered to consumers by a business outlet offering check-cashing services. In a typical payday loan transaction, the borrower writes the lender a post-dated check and, in return, the lender provides a lesser amount of cash to the consumer after subtracting interest and fees. Following this initial transaction, the lender holds the check for a specified period, during which the consumer has the option of either redeeming the check by paying the face amount to the lender or allowing the lender to cash the check after the loan period has expired.

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.

Terms of Small Loans. The following are terms of small loans:

- A borrower may not take out more than \$700 in small loans at any time from all lenders;
- A borrower may not borrow more than 30 percent of the borrower's gross monthly income;
- Fees are limited to 15 percent for the first \$500 and 10 percent for any amount that exceeds \$500;
- A borrower may not receive more than eight small loans in a 12-month period;
- 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 can enter into an installment plan, with no additional fee or interest, if the borrower feels that they cannot repay the loan when it is due. A borrower has up to six months to repay the loan in an installment plan. There are limitations on receiving subsequent small loans while in an installment plan;
- Other than a post-dated check, a licensee may not accept any other property, title to property, or other evidence of ownership of property as collateral for a small loan; and
- A borrower has one business day to rescind the loan, in which case the licensee may not collect any fees.

A violation of the Act is a per se violation of the Consumer Protection Act.

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.

Summary of Engrossed Substitute Bill: The small loans endorsement provisions in RCW 31.45 – the Act, 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 cashier 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 the following:

- an investigation and supervision fee established by the Department;

- fingerprints of each officer, director, and owner of the applicant for submission to the Washington State Patrol or the Federal Bureau of Investigation 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:

- Maximum loan amount: \$700
- Minimum term: 180 days
- Maximum term: 190 days
- Period between payments: At least 7 days

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

	Term	Notes
Origination Fee	15 percent	Amortized through the loan term, accruing daily
Annual Interest	36 percent	Amortized through the loan term, accruing daily
Monthly Maintenance Fee	7.5 percent, up to \$45 per month	Charged every month in which loan has unpaid balance

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. A borrower may not receive more than eight loans in any 12-month period.

Additionally, a small consumer installment loan must:

- amortize all principal and fees over the term of the loan;
- not be secured by a lien on any real property or personal property; and
- 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 at any one time does not exceed \$700.

Disclosure & Transaction Records. A licensee must post a schedule of the fees, penalties, and charges for taking out a small consumer installment loan in every location. A record of each small consumer installment loan transaction must be signed by the licensee and the borrower. Contents of the record are prescribed. Additionally 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.

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 30 days, the lender may charge a penalty of not more than \$25 and may declare the entire loan due and payable and proceed to collect the small consumer installment loan, including the unpaid balance of the loaned amount and interest, loan origination, and monthly maintenance fees accrued on the date the loan is declared due and payable.

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.

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 a term no less than 120 days and require an initial payment of no more than 20 percent of the total amount due. If a borrower defaults on a repayment plan, a licensee may pursue any legal remedy to collect the outstanding balance on the repayment plan.

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.

Department of Financial Institutions. 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. 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.

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 following:

- 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.

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.

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.

Beginning July 1, 2017, the Department must annually adjust the specified dollar amounts in the SCILA, including maximum loan amount, maximum monthly maintenance fee, and 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. From each small consumer installment loan transaction, \$2 must be remitted to the Department, \$1 to be used for financial literacy and education, and \$1 to be deposited in the asset building assistance account to be used by the Department of Commerce to fund grants for asset building activities.

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.

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

Appropriation: None.

Fiscal Note: Available.

[OFM requested ten-year cost projection pursuant to I-960.]

Committee/Commission/Task Force Created: No.

Effective Date: The bill takes effect on July 1, 2016.

Staff Summary of Public Testimony on Original Bill: PRO: There are situations where people get down on their luck, go out of business, or end up declaring bankruptcy. The only avenues available are high-cost loans. There is a need for this type of product. This bill seeks to provide a safe, regulated product in the state of Washington. It will reduce costs for most borrowers by adopting the installment loan program and eliminating payday lending. It allows the borrower to repay principal along the way, heading toward paying off the loan rather than having a big balloon payment at the end. Colorado has a similar program. Evidence has shown that most consumers pay off these loans in three months. There are concerns about how the bill is being characterized and its impact on consumers. This bill is based on the Colorado law. The same types of groups that are opposing the bill today, loved the installment loan bill in Colorado. Advocates frequently criticize balloon payments and this bill does away with that. It is not intellectually honest to compare a two-week loan to an installment loan. The Attorney General in Colorado says typically consumers contract for a six-month loan and pay it back in 99 days. For further comparisons, Colorado has a 45 percent interest rate, this bill has 36 percent. Colorado does not limit the number of loans that can be made. This bill caps the loans at \$1,000. Colorado does not have a loan term limit. This bill caps the time period at 12 months. Businesses have learned that consumers like the flexibility of longer loan terms with lower fees. This bill should not eliminate payday lending. The state should give people more choices and options.

CON: Consumer advocates consistently hear about the high cost of financial services. Not once have we heard from clients that they need more high cost loan options. The last thing they need is a high-cost loan that re-exposes them to the worst aspects of payday lending. Protections in the payday lending statute provide an off-ramp from the cycle of debt. No such protections exist in this bill. We are pleased that active military is prohibited from using this type of debt. However, this begs the question as to why this product is deemed unsafe for the military but perfectly safe for other citizens. A recent study from the Harvard Business School finds short-term credit increases the rate by which people overdraw their accounts. This is an unproven expensive loan product proposed to be put on the market with little study. Consumers cannot afford this experiment. Installment lending would result in worse outcomes for low-income people. Washington ranks high in studies on consumer protections for consumers on payday loans. This new system will leave low-income borrowers paying more. Payday lending was illegal until 1995. It took 15 years to get good reforms. Washington has an average APR that is third-lowest in the the nation and a default rate of 19 percent – Colorado is 38 percent. This is a complicated product that only one other state has adopted. There is no limit on the number of loans that can be taken out in one year. A 12-month loan will cost a person more than double the original loan amount. The Department payday report for 2014 shows a massive drop in online payday lenders. There are substantial differences between this program and the Colorado program. Colorado has no aggressive acceleration clause, the loan term is shorter, \$500 is the maximum amount of the loan, and the maintenance fee is not charged until the end of the second month.

OTHER: Collection agencies have some concerns that could be fixed with a minor amendment.

Persons Testifying: PRO: Senator Liias, prime sponsor; Dennis Bassford, President, Moneytree, Inc.

CON: Marcy Bowers, Statewide Poverty Action Network; Bruce Neas, Columbia Legal Services; Eric Gonzalez, One America.

OTHER: Chester Baldwin, WA Collection Assn.

Persons Signed in to Testify But Not Testifying: CON: Mike Tucker, AARP; Seth Dawson, WSCAP; Joe Sky Tucker, Express Advantage Credit Union; Paul Benz, Faith Action Network.