

HOUSE BILL REPORT

ESSB 5899

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: 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:

Business & Financial Services: 3/24/15, 3/25/15 [DPA].

**Brief Summary of Engrossed Substitute Bill
(As Amended by Committee)**

- Creates a new small consumer installment loan regulated by the Department of Financial Institutions.
- Eliminates traditional payday loan product.
- Permits a loan of up to \$700 for a six month term.
- Allows an origination fee of 15 percent of the loaned amount, spread 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 \$45 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.

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: Do pass as amended. Signed by 7 members: Representatives Kirby, Chair; Vick, Ranking Minority Member; Blake, Hurst, Kochmar, McCabe and Santos.

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

Minority Report: Without recommendation. Signed by 1 member: Representative Stanford.

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.

Licensees under the CLA may charge interest in excess of the usury rate. A licensee may charge:

- up to 25 percent per annum as determined by the simple interest method of calculating interest owed; and
- a nonrefundable, prepaid loan origination fee not to exceed 4 percent of the first \$20,000 and 2 percent of the sum above \$20,000. The fee may be included in the principal balance of the loan.

A CLA licensee may also offer an "open-end loan." An open-end loan is a revolving loan that allows the borrower to take advances up to the permitted amount. Charges are computed on the unpaid balance periodically. The borrower may pay in monthly installments that are fixed or determinable. The borrower may pay the full amount at any time without a prepayment penalty. Interest on an open-end loan must not exceed 25 percent per annum computed in each billing cycle calculated by any of the prescribed methods. A licensee may charge an annual fee of up to \$50, payable in advance, for opening and maintaining an open-end loan account.

Small Loans (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.

Summary of Amended 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.

The Department may require the applicant to apply through a multistate licensing system and pay a fee for use of the system.

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

Terms.

Small consumer installment loans are subject to the following limits:

<i>Maximum loan amount:</i>	\$700
<i>Minimum term:</i>	180 days
<i>Maximum term:</i>	190 days
<i>Period between payments:</i>	At least seven days
<i>Maximum loans per borrower:</i>	Eight per year

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

	Term	Notes
<i>Origination fee</i>	15 percent	Spread evenly 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 \$45 per month	Charged every month in which loan has an 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. The licensee must also display its unified business identifier number at each location and on all websites and internet advertising.

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, cash, 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 30 days, the lender may charge a penalty of not more than \$25 and may declare the entire loan due and payable (accelerate the loan). The lender may not collect interest and fees accruing after the date the loan is accelerated. If there is a balance outstanding after the final scheduled payment date, the lender may not charging interest or fees accruing after that date.

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>	120 days, unless otherwise agreed
<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, require collateral, or sell insurance to the borrower. 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 and to implement the elimination of payday loans in the CCSA. The director of the Department has broad administrative discretion in administering the act and effectuating its intent.

The Department must set and adjust fees authorized in the CCSA.

Adjustments for Inflation.

Beginning July 1, 2017, the Department must annually adjust the maximum loan amount 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.

Amended Bill Compared to Engrossed Substitute Bill:

The striking amendment requires a small consumer installment loan licensee to display its unified business identifier number at licensed locations and on any website used for advertising or accepting applications for small consumer installment loans.

It also eliminates the creation of an asset building grant program in the Department of Commerce and eliminates funding to the program.

Appropriation: None.

Fiscal Note: Available.

Effective Date of Amended 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 20 through 51, 53 through 55, and 56 become law as enacted by the Legislature; and sections 20 through 55, relating to small consumer installment loans, which take effect July 1, 2016.

Staff Summary of Public Testimony:

(In support) The product provided for in this bill will be good for consumers. It elongates repayment terms and provides flexibility and choice to consumers, all of which help

consumers meet their short-term needs while enhancing their ability to repay. Further, other choices, such as credit union loans, will remain available to consumers.

The opposition to this bill is baffling because the bill contains every consumer protection available in current law and does not require a constructive declaration of default before an installment plan is available. Opponents claim to make an apples-to-apples comparison, but it is intellectually dishonest to compare a single payday loan for one to two weeks with a six-month loan. The opposition is rooted in a dislike for the industry and the companies involved rather than the product itself. Opponents would rather see consumer demand met by unlicensed, illegal, or off-shore lenders, and they have not offered a constructive alternative.

(Opposed) The strategy of asset building is to stabilize communities with financial education and opportunity, and debt poses an enormous barrier to the goals of asset building. Asset building coalitions did not ask to be included in the bill. Funding asset building through these loans would take money from the people asset building coalitions seek to help. Like payday lending, this bill would strip assets from consumers and simply dress up a bad product.

Further, the existing law already provides an installment plan option at no additional cost for those who need more time to pay. It is incorrect to say that consumers must default in order to enter a repayment plan. In fact, the number of borrowers defaulting on payday loans has declined since 2009 while credit card default rates have increased.

The current system is not broken, so there is no need to fix it. People in poverty have not been asking for a new loan product, and the number of complaints about payday lending has fallen dramatically since the reforms in 2009. Washington now has one of the lowest average annual percentage rates and one of the shortest loan lengths in the country. The Pew Charitable Trusts, which opposes this bill, supported the 2009 reforms. There is no need to throw those reforms away.

It is good that military members are excluded from the bill, but if it is too dangerous for them, is it not also too dangerous for other consumers?

An apples-to-apples comparison indicates that payoff must occur before 45 days after loan origination in order for the borrower to realize a savings. However, comparing payday loans to installment loans is similar to comparing cigarettes to light cigarettes. They are both very bad for the consumer.

While there is demand for small-dollar credit, other products that are structured to help facilitate successful repayment can meet that need. Some nonprofit credit unions are able to offer loans that help consumers meet short-term need without stripping assets.

Payday lending and installment lending is a labor issue as it disproportionately affects working families. It is also a moral issue in that we must help those in need avoid usury and excessive interest, avoid pushing people deeper into debt, and avoid broadening economic disparity.

(Information only) The Department does not have a complete number of unlicensed online lenders, but it received 329 complaints regarding unlicensed online lenders in 2013 and 85 in 2014. Only one was received in relation to licensed online lenders.

Persons Testifying: (In support) Representative Springer; and Dennis Bassford, Moneytree, Incorporated.

(Opposed) Stephanie Bowman, Washington Asset Building Coalition; Mindie Reule, Thurston Asset Building Coalition; Allyson Bazan, Office of the Attorney General; Marcy Bowers, Statewide Poverty Action Network; Teresa Mosqueda, Washington State Labor Council; Rolando Avila; Eric Gonzalez, One America; Seth Goldstein, Jewish Federation; Paul Benz, Faith Action Network; Steve Breaux, Service Employees International Union 775; and Joe Sky Tucker, Express Credit Union.

(Information only) Charlie Clark, Department of Financial Institutions.

Persons Signed In To Testify But Not Testifying: None.