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PAYDAY LOANS

Throughout the country, payday loans make up the newest and fastest growing form of short-term lending. In Wisconsin alone, the Department of Financial Institutions (DFI) reported 839,285 loans totaling \$200.2 million in 1999, a surprising increase from 1996, which recorded approximately 80,000 loans at \$11.2 million. DFI data also showed the number of licensed lenders almost doubled from 17 firms with 64 locations in 1996 to 31 firms at 174 locations in 1999.

Questions have been raised about regulation of payday loan practices. Payday lenders assert they are providing a needed service not available through traditional financial institutions, while consumer groups question the finance charges assessed for the loans. In its 1999-2000 session, the Wisconsin Legislature considered two approaches to further regulate payday lending within the state (Senate Bill 96 and Assembly Bill 612), but neither passed. The senate proposal dealt with setting maximum interest rates for loans. The assembly measure would have required the lender to provide more detailed information to consumers about the loans.

PAYDAY LENDING PROCEDURES

The typical payday loan customer is living “from paycheck to paycheck” and needs a cash advance to bridge that gap. The lender makes a small loan against the borrower’s personal check, which is held for deposit on a future date, such as the date the checkwriter will be collecting a paycheck. Loans generally range from \$100 to \$500, with an initial duration of one to two weeks, although some run as long as 10 months. If necessary, the borrower often is allowed to renew the loan for an additional period, called a “roll-over”, and it is not unusual for loans to be renewed week after week. A study by the Indiana Department of Financial Institutions of 5,350 payday loan customers showed the average borrower rolled over a loan about 10 times.

To illustrate a payday loan transaction: an individual writes a check for \$115 and receives \$100 in cash, but the lender agrees not to cash the check for two weeks. The actual cost of the 2-week loan is the \$15 difference, which works out in this case to an annual percentage rate (APR) of 390%. If the individual cannot afford to have the check cashed on the agreed date, he or she may decide to pay a separate finance charge of \$15 to roll the loan over, increasing the total finance charges to \$30 for a \$100 one-month loan. Lenders usually do not conduct any credit checks on prospective borrowers other than verifying their checking accounts and employment.

Payday lenders admit their loan charges are relatively high compared to standard loans at financial institutions, but they claim high fees are necessary to offset the write-off of bad debts. Only a few states collect payday loan information, but Colorado, which does track these loans, reported in 1998 that payday lenders in that state wrote off 3.9% of loans, which is less than what banks wrote off in credit card debt for the same period.

State Regulation of Payday Loans

State	Applicable % Interest Cap	Min./Max. Term	Maximum Amount	Max. Fees Percent/\$	Effective APR for 14 days ¹
Alabama ²	36%	---	---	---	---
Alaska	36	---	---	---	---
Arizona	36	---	---	---	---
Arkansas	---	6/31 days	\$400 ck	10% + \$10	546%
California	---	_/30 days	\$300 ck	15% of ck	459
Colorado	---	NA	\$500 ck	\$25	650
Connecticut*	28.52	---	---	---	---
Delaware	---	---	---	---	---
Florida	---	NA ³	NA	10% + \$5	419
Georgia*	57.68	---	---	---	---
Hawaii	---	_/31 days	\$300 ck	15% of ck	459
Idaho	---	---	---	---	---
Illinois	---	---	---	---	---
Indiana	36	---	---	---	---
Iowa	---	_/31 days	\$500 ck	\$15 first \$100 ⁴	459
Kansas	---	_/30 days	\$860	---	390
Kentucky	---	14/60 days	\$500 ck	\$15 per \$100	459
Louisiana	---	_/30 days	\$350 loan	16.75% ck	520
Maine*	30	---	---	---	---
Maryland	33	---	---	---	---
Massachusetts*	39.86	---	---	---	---
Michigan ⁶	25	---	---	---	---
Minnesota	---	_/30 days	\$350 loan	---	390
Mississippi	---	_/30 days	\$400 ck	18% ck	572
Missouri	---	14 days/10 mo.	\$500 loan	\$15 per \$100	390
Montana	---	_/31 days	\$300 loan	25%	871
Nebraska	---	_/31 days	\$500 ck	\$15 per \$100	459
Nevada	---	NA	% ⁷	NA	---
New Hampshire ⁸	24	---	---	---	---
New Jersey*	30	---	---	---	---
New Mexico	---	---	---	---	---
New York*	25	---	---	---	---
North Carolina	---	_/31 days	\$300 ck	15% ck	459
North Dakota	30	---	---	---	---
Ohio	---	_/6 mo.	\$500 loan	5%/5-\$50	390
Oklahoma	---	30 days/NA	\$102	---	364
Oregon	---	---	---	---	---
Pennsylvania*	23.75	---	---	---	---
Rhode Island	36	---	---	---	---
South Carolina	---	_/31 days	\$300 loan	15% ck	459
South Dakota	---	---	---	---	---
Tennessee	---	_/31 days	\$500 ck	15% ck	459
Texas	31.65	---	---	---	---
Utah	---	NA	NA	No limits	---
Vermont	24	---	---	---	---
Virginia*	36	---	---	---	---
Washington	---	_/31 days	\$500	15% loan	390
West Virginia*	31	---	---	---	---
Wisconsin	---	---	---	---	---
Wyoming	---	_/30 days	NA	20% or \$30	780

NA - Not applicable; ck - check.

*Check casher's law bans payday loans.

¹Approximate annual percentage rate (APR) without compounding.

²Payday loans permitted under court injunction while litigation pending.

³Loan roll-overs or extensions violate Florida's usury and/or consumer finance act.

⁴\$10 on each additional \$100.

⁵Scale of fees and/or percentages related to size of loan.

⁶License not required if interest charges are no more than 5% per annum plus the check casher's fee. Check casher's fees not regulated.

⁷Maximum loan not to exceed one-third of borrower's expected net monthly income.

⁸Effective 1/1/2000 licensed lenders can charge any rate agreed to by customers, thereby allowing payday loans.

Sources: Compiled from various publications of the Consumer Federation of America, updated through September 1999.

REGULATION OF PAYDAY LOANS IN WISCONSIN AND OTHER STATES

With the enormous growth of payday loans in the last few years, state legislatures have been investigating the problems associated with this type of lending, and many have passed legislation to regulate it. Currently, 23 states (most recently Arkansas, Hawaii, Montana, and Utah in 1999) specifically authorize payday lending and exempt lenders from small loan interest caps or usury laws. Another eight, including Wisconsin, have no usury laws to regulate rates. The remaining 19 states have restrictive interest caps that tend to limit the volume of payday lending.

Some states set payday loan fees at a maximum percentage of the face value of the total check, others impose the percentage fee on the proceeds of the loan, and a few set a sliding fee scale related to the size of the loan. (Nationally, the average APR for payday loans is 474%.)

Wisconsin lenders (other than banks, savings institutions, and credit unions) generally must obtain a license from DFI's Division of Banking in order to charge interest greater than 18% APR, but there is no statutory maximum on the interest rates or fees charged by these licensed lenders. APR rates for a \$100 loan for 14 days range from 390% to 780% in Wisconsin.

MODEL DEFERRED DEPOSIT LOAN ACT

The National Consumer Law Center (NCLC) has developed the Model Deferred Deposit Loan Act to address specific aspects of payday loans, including fee structure, roll-overs, borrowers' use of multiple loans or multiple lenders, and the use or threatened use of courts for loan collection. The model for state legislation also proposes tighter regulation of payday loan business practices to strengthen compliance with existing state consumer protection provisions. The model act also provides for a private right of action so consumers can obtain remedies when the law is violated.

Existing Protections in Wisconsin. Wisconsin law and, to some extent, federal law already provide some of the consumer protections recommended in the NCLC model act.

- When licensing payday lending firms, DFI investigates the character, general fitness and financial responsibility of the lender. It may require a bond of up to \$5,000 per location, which may be used to pay damages and penalties to consumers harmed by a lender's actions.
- DFI may suspend or revoke a lender's license under certain circumstances and is required to receive and act upon complaints from consumers.
- Lenders must file annual reports and keep prescribed books and accounts, which are open for DFI inspection.
- Lenders must provide a written agreement that specifies the details of the loan, including fees and charges, truth-in-lending disclosures, and repayment obligations.
- The law permits prepayment of loans and requires a refund of unearned fees on the amounts repaid before due date.
- Lenders are prohibited from engaging in unfair, deceptive, or fraudulent practices in making or collecting payday loans, including using or threatening to use the criminal process to collect overdue loans.

- Consumers have civil remedies against lenders, and criminal penalties, including maximum fines of \$2,000 per violation, are provided for willful and knowing violations of the law.
- Wisconsin common law, based on state court decisions, forbids unconscionable contracts, and that prohibition applies to payday loans.

Other Issues Raised in the Model Act. The model act raises additional issues, which are not currently addressed in Wisconsin or federal law (although some were covered in the bills introduced in the 1999 Legislature). The act proposes:

- Maximum and minimum limits on the amount and duration of each loan.
- Maximum limits on interest rates and administrative fees charged for loans.
- Prohibiting a lender from making more than one payday loan to a single customer at a time or issuing a second loan to the person unless 30 days have elapsed after termination of the first loan, thereby essentially preventing roll-overs.
- Increased disclosure about payday loan procedures to ensure consumer awareness of the effects of contracting such obligations.

A copy of the NCLC's Model Deferred Deposit Loan Act is available on their Web site at www.nclc.org/PayDayLoans.