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REGULATION OF PAYDAY LOAN PROVIDERS

INTRODUCTION

Payday loans constitute one of the fastest growing forms of short-term lending. This trend is clearly apparent in Wisconsin where the Department of Financial Institutions (DFI) has licensed 346 payday lending companies as of April 2, 2004, compared to two such companies licensed in 1995.

A “payday loan” is a loan made against a borrower’s personal check or electronic fund transfer agreement, which is held by the lender for deposit on a future date. Payday loans are frequently relied upon by individuals who are living from paycheck to paycheck, and need a cash advance to bridge that gap. Payday lenders assert that they are providing a needed service not available through traditional financial institutions. Consumer groups question the charges assessed for the loans. With the large increase in the number of payday lenders in Wisconsin, the question of specific regulation of payday loan practices has been raised.

In an attempt to address these questions, the 2003-2004 Wisconsin Legislature passed 2003 Assembly Bill 665, which would have provided for specific regulation of payday loan companies operating in Wisconsin. The bill was vetoed by Governor Jim Doyle because he felt that the bill did not go far enough in protecting consumers.

This brief focuses on the background of payday loans, current law and proposed legislation, and activities in other states.

BACKGROUND

Payday loan companies make short-term loans to consumers by accepting a post-dated check or electronic fund transfer agreement with proper identification, charging a fee, and providing immediate cash. The average loan ranges from \$100 to \$500. Consumer organizations, including the Consumer Federation of America and the National Consumer Law Center, object to payday loan practices because companies assess fees amounting to an annual interest rate of 300% or greater. In many cases, borrowers roll their loans over two or three times incurring additional fees. By the time they repay, the additional fees could exceed the original value of the loan and the annual interest rate may exceed 1,000%.

During the summer of 2000, DFI conducted a review of 17 Wisconsin payday loan operations to determine how they were used and who used them.

DFI concluded that consumers who use payday lenders came from “a broad spectrum in terms of age and income”. For loan applicants reporting net income, the average was \$18,675 annually. For those who reported gross income, the average was \$24,673. Renters constituted more than 60% of loan applicants in the study. DFI determined that the average loan length among those reviewed was 14 days, and that the average disclosed annual percentage rate of all reviewed loans was 542.2%.

CURRENT LAW

DFI licenses and regulates payday loan companies under Section 138.09, Wisconsin Statutes.

Wisconsin lenders (other than banks and credit unions) must obtain a license from DFI's Division of Banking in order to charge interest greater than 18% annual percentage rate (APR). There is no statutory maximum on the interest rates or fees charged by these licensed lenders.

Wisconsin law and, to some extent, federal law already provides some consumer protections.

- 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, for willful and knowing violations of the law.
- Wisconsin common law, based on state court decisions, prohibits unconscionable contracts, and that prohibition applies to payday loans.

2003 ASSEMBLY BILL 665

2003 Assembly Bill 665 was introduced by Representative Suzanne Jeskewitz and others. Industry representatives and state regulators helped develop the bill. The bill passed the assembly on March 10, 2004, by a vote of 66-33, and was concurred in by the senate on March 11, 2004, by a voice vote. The governor vetoed the bill on April 15, 2004.

AB-665 proposed a number of new requirements relating to payday loans.

Prohibitions. The bill prohibited payday loan providers from doing the following:

- They may not make loans that exceed \$5,000 of principal (adjustable by the Department of Financial Institutions for inflation).
- They may not make a payday loan with an original payment date more than 35 days after the loan origination date.
- They may not initiate or threaten to initiate criminal prosecution against an applicant because the applicant's check or electronic transfer has not been paid by the financial establishment from which it is drawn or transferred. However, loan providers may cooperate with law enforcement

agencies that bring an independent criminal action against the applicant.

- They cannot roll over a payday loan more than four consecutive times.
- The applicant may cancel all obligations before the close of the next business day following the transaction.

Disclosure Requirements. Before disbursing funds, a payday loan provider must provide to the applicant all of the following in a clear and conspicuous printed notice:

- A payday loan is not intended to meet long-term financial needs.
- An applicant should use a payday loan only in a financial emergency.
- The applicant must pay additional interest if the original loan is refinanced rather than paid in full when due.
- Refinancing a payday loan or entering into consecutive payday loans to pay an existing payday loan may cause financial hardship for the applicant.
- A statement that compares the cost when the applicant pays the payday loan in full at the end of the loan term with the cost of paying the loan in full after financing the amount of the loan at the end of the loan term three consecutive times.

GOVERNOR'S VETO MESSAGE

In his veto message for AB-665, Governor Doyle stated:

The provisions of this bill do little to change the current practices of payday lenders or to improve on current con-

sumer protection laws. Consumers who turn to payday lenders in times of financial need are often vulnerable and not in the position to fully consider the terms of the agreement in the few minutes it takes to process these transactions. Current law already limits fees and interest paid on consumer loans for which principal is returned within one day. In addition, the department's authority has already been interpreted to protect payday loan recipients from prosecution under worthless check statutes. Finally, without a means of tracking payday loans, provisions limiting the number of consecutive transactions will be unenforceable. I encourage the Legislature to work with my administration and other concerned groups to draft legislation that will make real changes in the regulation of payday lending and that will ensure the protection of Wisconsin consumers.

In response, Representative Jeskewitz issued a press release in which she conceded that the bill may not have been perfect, but it was better than current law. She also stated that she worked with both the Department of Financial Institutions and the payday industry to find a compromise that would be good for the consumer and allow honest payday lenders to operate in Wisconsin.

REGULATION OF PAYDAY LOANS BY OTHER STATES

Currently, 25 states specifically authorize payday lending and exempt lenders from small loan interest caps or usury laws. Eleven states prohibit payday loans through small loan interest rate caps, usury laws, or specific prohibitions on check cashing operations.

State Regulation of Payday Loans

State	Min./Max. Term	Maximum Amount	Maximum Fees or Percentage
Alabama	NA	\$500	17.5% of check
Alaska*	---	---	---
Arizona	NA	\$500	15% of check
Arkansas	6/31 days	\$400	10% + \$10
California	_/30 days	\$300	15% of check
Colorado	_/40 days	\$500	20% for first \$300 and 7.5% > \$300
Connecticut*	---	---	---
Delaware	NA	NA	No limit
Florida	7/31 days	\$500	10%
Georgia*	---	---	---
Hawaii	_/31 days	\$600	15% of check
Idaho	NA	\$1,000	No limit
Illinois	_/30 days	\$400/50% of gross income term of loan	No limit
Indiana	NA	\$401	15% first \$100 (10% on each additional \$100) Not to exceed \$35
Iowa	_/31 days	\$500	\$15 first \$100 (\$10 on each additional \$100)
Kansas	_/30 days	\$860	Fee scale/percentages related to size of loan
Kentucky	14/60 days	\$500	\$15 per \$100
Louisiana	_/60 days	\$350	16.75% of check
Maine*	---	---	---
Maryland*	---	---	---
Massachusetts*	---	---	---
Michigan*	---	---	---
Minnesota	_/30 days	\$350	Fee scale/percentages related to size of loan
Mississippi	_/30 days	\$400	18% of check
Missouri	14 days/10 mo.	\$500	No interest/fees in excess of 75% of loan
Montana	_/31 days	\$300	25%
Nebraska	_/31 days	\$500	\$15 per \$100
Nevada	NA	No limit	No limit
New Hampshire	NA	\$500	No fees
New Jersey*	---	---	---
New Mexico	NA	No limit	No limit
New York*	---	---	---
North Carolina	---	---	---
North Dakota	_/45 days	\$500	20%
Ohio	_/6 mo.	\$500	5%/\$5 per \$50
Oklahoma	1 mo./10 mo.	\$500	\$15 per \$100 ≤ \$300 additional \$10 per \$100 > 300
Oregon	---	---	---
Pennsylvania	---	---	---
Rhode Island	---	\$300	---
South Carolina	_/31 days	\$300	15% of check
South Dakota	NA	\$500	No limit
Tennessee	_/31 days	No limit	No limit
Texas	7/31 days	\$350	48% APR + \$10
Utah	NA	No limit	No limit
Vermont*	---	---	---
Virginia	NA	\$500	15% of loan
Washington	_/31 days	No limit	15% of first \$500, additional 10% > \$500
West Virginia*	---	---	---
WISCONSIN	NA	No limit	No limit
Wyoming	_/30 days	No limit	Greater of \$300 or 20% of balance per month

*State bans payday loans. NA – Not applicable.

Sources: Consumer Federation of America, "Rent-A-Bank Payday Lending", November 2001; National Conference of State Legislatures, "Payday Lending", April 2004.