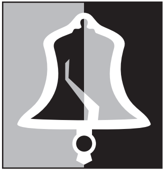

The Bell Policy Center

STATE and LOCAL OPPORTUNITY NOTE

HB 08-1310

POSITIVE

Drafting Number: LLS 08-0687.01
Prime Sponsor: Rep. M. Ferrandino, D-Denver
Sen. Peter Groff, D-Denver

Date: Feb. 18, 2008
Bill Status: House Business Affairs & Labor
Policy Analyst: Rich Jones (303) 297-0456

Title: Concerning Deferred Deposit Loan Transactions

This bill represents an opportunity gain for Colorado by reducing the costs of payday loans and extending the time allowed to repay them. This will address the current flaws in how these loans are currently structured and remove their predatory features. According to the Center for Responsible Lending, eliminating the predatory aspects of payday loans will put $76 million back into the pockets of Colorado payday borrowers. [1]

Summary of Legislation

This bill changes the allowable finance fees that can be charged for "deferred deposit loans," commonly called payday loans. In 2000, the Colorado General Assembly created a special provision within the Uniform Consumer Credit Code to allow deferred-deposit loans and exempt them from Colorado's usury cap of 45 percent annual percentage rate (APR). This law, the Deferred Deposit Loan Act (DDLA), gave the payday lending industry legislative clearance to charge fees that amount to APRs that average more than 350 percent.

Under the DDLA, loans cannot exceed $500, or no more than 25 percent of the borrower's gross monthly income, whichever is smaller. Lenders can charge a maximum fee of $20 per $100 borrowed on the first $300 of a loan and $7.50 per $100 borrowed between $300 and the maximum $500. The maximum fee for a $300 loan is $60 and $75 for a $500 loan. The loan term cannot exceed 40 days, and loans can be renewed once, with renewals subject to the same limits on finance fees as the original loan. Loans require a written agreement signed by both the lender and the borrower, and borrowers can cancel a loan by 5 p.m. the following business day. On the fourth consecutive payday loan, lenders are required to offer a repayment plan allowing borrowers to repay the loan in six equal installments at no additional charge.[2]

House Bill 08 1310 would limit payday lenders to one origination fee in a twelve-month period, set at $10 per $100 borrowed up to a maximum fee of $30. In addition, lenders can charge a maximum interest rate of 36 percent APR. It also sets a minimum loan term of 30 days after the loan origination. Payday lenders would be prevented from making a loan to a borrower who has an outstanding payday loan with them or any other lender; the bill also requires a confidential database, run by an outside vendor and overseen by the attorney general. Lenders would be required to pay up to $1.00 per transaction for the cost of the database.

Background

In Colorado, payday loans average about $350 with a term of about 18 days. To qualify, borrowers need meet only minimal requirements: proof of identification, a checking account and steady income, such as a paycheck stub. Borrowers write a check, post-dated to their next payday, for the amount borrowed plus the cost of the finance fee. They can also give the lender direct access to withdraw this amount from their bank account. The check or bank account access is held as security on the loan.

If borrowers can not repay the loan when it is due, they can renew it once for the same fees as the original loan. While payday loans can be renewed only once, there is no prohibition from making a new loan on the same day that a previous loan is paid off. The attorney general's office determined that this practice mimics refinance transactions. The attorney

The Bell Policy Center believes a top priority of the General Assembly should be to expand opportunities for Coloradans to achieve the American Dream. In that spirit, we offer Opportunity Notes on selected bills. Similar to Fiscal Notes, Opportunity Notes reflect our best analysis of whether a bill, if implemented, will expand opportunities for Coloradans.

A POSITIVE analysis means our research suggests a bill will expand opportunity in a cost effective manner.

A NEGATIVE analysis means our research suggests the measure will restrict opportunities or will not cost-effectively achieve its goals.

general's office concludes, "… in 2007, 65.4% of all DDLA loans written were 'refinance-type' transactions where the consumers remained indebted to the lender."[3] The 2006 and 2007 reports on payday lending issued by Colorado's attorney general present the following data.[4]

	2006	2007
Average loans per borrower	9	9.7
% refinance-type loans	65%	65%
Average APR	353%	348%
Average payday loan	$343	$354
Average finance fees/loan	$544	$573
Borrowers' median gross monthly income	$2,167	$2,172
% loans to borrowers with 11+ loans	70%	70%

Research and Evidence of Effectiveness

A number of states and the U.S. Department of Defense (DoD) have recently acted to impose tighter regulation on payday lenders. In 2007, the DoD determined that payday loans were a harmful product and mandated a 36 percent rate cap on payday loans to military personnel and their dependents. The DoD found that payday loans met their four criteria for predatory loans: lending without regard of the borrower's ability to repay; excessive fees and excessive interest rates; balloon payments with unrealistic repayment terms; and wealth-stripping associated with repeat rollovers/financing. The DoD concluded that payday loans are "detrimental to a service member's financial well-being and inferior to alternative sources of emergency support."[5]

The North Carolina legislature permitted its statute allowing payday lending to sunset in 2001, and all lenders were forced to leave the state by 2006. In a study conducted for the North Carolina Commissioner of Banks, the University of North Carolina's Center for Community Capital found that the absence of payday lending has had no significant impact on the availability of credit for North Carolina households. Through a survey of low- and middle-income residents and focus groups with former payday borrowers, the center's researchers found that "more than twice as many former payday borrowers reported that the absence of payday lending has had a positive rather than negative effect on their household." The former payday borrowers wanted loans with a lower APR, longer repayment terms, the ability to amortize payments and limits on renewals and the amounts borrowed.[6]

In 2007, Oregon imposed a 36 percent APR on payday loans along with an origination fee of $10 per $100 borrowed for the first loan, up to a maximum of $30. The loan can be renewed twice at 36 percent APR but with no origination fee. The payment term is extended to 31 days.[7] As of January 2008, about 75 percent of Oregon payday lenders have given up their licenses. However, a number of credit unions have begun to offer small loans for as long as 30 days at rates of about 18 percent APR. Advocates in Oregon assert that low-income borrowers have access to credit and have not been harmed by the loss of payday lenders.[8]

Estimate of Impact and Benefits

The Center for Responsible Lending, a North Carolina-based non-profit nationally recognized for its expertise on credit issues, calculated that eliminating the predatory nature of payday loans will put $76 million back into the pockets of Colorado payday borrowers.[9]

End notes

[1] King, Uriah, Leslie Parrish and Ozlem Tani. 2006. Financial Quicksand: Payday Lending sinks borrowers in debt with $4.2 billion in predatory fees every year. Appendix 2. The Center for Responsible Lending.

[2] Deferred Deposit Loan Act. Colorado Title 5 C.R.S. 3.1-101-121.

[3] Payday Lending Demographic and Statistical Information, July 2000 through December 2007. Colorado Attorney General, Administrator of the Colorado Uniform Consumer Credit Code, February 4, 2008.

[4] Ibid, and the same report for July 2000 through December 2006 released March 8, 2007.

[5] Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rule. U.S. Department of Defense. Federal Register, August 31, 2007, pp. 50580-50594.

[6] North Carolina Consumers After Payday Lending: Attitudes and Experiences with Credit Options. Center for Community Capital. University of North Carolina. November 2007.

[7] Oregon Revised Statutes 725.340 and 725.622

[8] Bell Policy Center staff interviews with Oregon legislative coordinator of the Division of Finance and Corporate Securities and Oregon advocates who work on credit issues.

[9] See, footnote 1.