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Blueprint for Opportunity

No. 20

Implementation Memo

TO: Governor Ritter
Members of the 66th Colorado General Assembly

FROM: The Bell Policy Center – Rich Jones, Director of Policy and Research

DATE: January 11, 2007

**RE: Implementing Bell's Blueprint recommendation No. 20
to crack down on predatory lending**

In the 2006 Blueprint for Opportunity, the Bell Policy Center recommends:

Crack down on predatory lending.

The legislature should review Colorado's current laws that regulate the payday lending industry and limit predatory mortgage lending with the goal of strengthening both statutes.

We should adopt stricter standards for payday lenders, including capping finance charges, prohibiting borrowing from one payday lender to pay off another, and eliminating special protections for payday lenders.

Colorado also should adopt provisions from the North Carolina law to protect families that buy or refinance their homes. These provisions ban prepayment penalties on loans of less than \$150,000, ban financing fees through high-cost loans, and require borrowers to use financial counseling. (*See Blueprint, page 27*)

This memorandum briefly discusses the issues surrounding this proposal, describes steps for implementing it, outlines some of the factors to consider and lists sources for additional information and resources.

If you are interested in pursuing this issue further, we are prepared to work with you. Please contact Rich Jones, director of policy and research, at (303) 297-0456 or jones@thebell.org.

Overview of the issue

Predatory lending costs Colorado consumers tens of millions of dollars a year in stripped home equity and excessive interest. It also traps families in a cycle of debt that can be devastating.¹

Abusive credit terms, extraordinarily high interest rates, and practices that make it hard for people to pay off or refinance their loans are symptomatic of predatory loans. Most predatory loans occur in the sub-prime lending market, where lenders charge high interest rates for loans made to borrowers with imperfect credit

histories. The higher interest rates compensate for the possibility that the loans will not be repaid. Not all sub-prime loans are predatory, but nearly all predatory loans are made in the sub-prime market.

During the 1980s the federal government deregulated the consumer credit market, overturning many state consumer protections. Some states responded by passing laws against predatory lending; many state laws are stronger than the federal protections.

Most predatory lending occurs in two markets – sub-prime mortgage lending and payday loans.



Predatory mortgage lending

Colorado enacted protections against predatory mortgage lending in 2002 through HB 02-1259, but the protections are not as strong as those enacted in other states. New Jersey, New Mexico, North Carolina and Texas are among the states considered to have stronger provisions than Colorado. These include restricting prepayment penalties for sub-prime loans, limiting financing of fees and requiring credit counseling for borrowers.²

The goal of eliminating hidden and often confusing fees is to encourage sub-prime lenders to compete on the basis of interest rates, which are more transparent to borrowers.

Payday lending

In 2005, a quarter million Coloradans borrowed almost \$500 million from payday lenders, according to the Colorado Attorney General's Office. The average payday loan was about \$300, with an average annual percentage rate of 345 percent. Almost 15 percent of borrowers took out 13 or more payday loans during the year. While these loans are characterized as high risk, payday lenders wrote off 4.3 percent of all loans as uncollectible.³

Colorado adopted the Deferred Deposit Loan Act in 2000 (SB00-144) to regulate payday lending. However, it did not contain the consumer protections recommended by experts. In fact, payday lenders are given "special substantive and procedural protections" as part of legislation passed in 2004 (HB04-1069).⁴

Payday lenders often establish relationships with banks in states with very high or no limits on small loan interest rates. They use these relationships to circumvent more stringent interest rate caps in the states where they make loans by claiming to "export" the cap from their home state. This practice is allowed under federal law. But Georgia, Maryland and Massachusetts restrict partnerships with out-of-state banks used for the purpose of circumventing state caps on payday loans.⁵

In October 2006, the U.S. Congress approved an amendment to the 2007 Defense Authorization Bill (S. 2766) setting a 36 percent annual percentage rate (APR) cap on payday

loans to military personnel. This is the same cap many states, including Colorado, set for small loans to outlaw loan sharking. The amendment also requires uniform disclosure of fees, bans loans made without regard to the borrowers' ability to repay, bans contract terms that require members of the military to waive their legal protections, and applies state consumer protection laws to service members.⁶

We should strengthen our laws by adopting provisions used in other states that have been found to reduce predatory lending without drying up the availability of capital to the sub-prime market. We should also extend the protections afforded to military members to all Coloradans.

Implementation steps

To strengthen protection against predatory mortgage lending, the legislature should amend CRS 5-3.5-101 to 5-3.5-303 to add the following provisions:

- Broadly define loans covered by the law to include purchase loans and home equity lines of credit.
- Ban prepayment penalties on loans of less than \$150,000.
- Ban financing of fees in high cost loans.
- Require that high cost loan borrowers receive financial counseling before entering into the loan.

To strengthen protection against predatory payday lending, the legislature should amend CRS 5-3.1-101 to 5-3.1-123 to add the following provisions:⁷

- Cap the interest rate on payday loans at 36 percent APR, no matter the size of the loan.
- Define "lender" to include affiliates or similar related entities.
- Base the definition of "loan splitting" on whether it results in obtaining a higher finance charge as opposed to the current definition, which is based on the lender's purpose.

- Prohibit the practice of using one payday loan to pay off another, and mandate a seven-day cooling-off period between the time one payday loan is paid off and when any lender may extend a new payday loan to the same borrower.
- Create a statewide database to track payday loans to consumers, and require all payday lenders to subscribe.
- Prohibit lenders from extending payday loans to consumers who already have payday loans outstanding with any other payday lender.
- Repeal provisions of HB04-1069 that give special privileges and protections to payday lenders.
- Prohibit payday lenders from making loans through nominal partnerships with out-of-state banks to circumvent Colorado's 36 percent APR cap on small loans.

Factors to consider

Those opposing more stringent consumer protections may argue that this will reduce credit available to borrowers in the sub-prime market. They may also cite research sponsored by the payday loan industry that shows sub-prime loans declined in states that passed strong protections against predatory lending.

However a nationwide analysis by the nonprofit Center for Responsible Lending of more than 6 million sub-prime mortgage loans, totaling \$1.2 trillion and issued from January 1998 through December 2004, found that strong state laws do not hamper consumers' access to sub-prime credit. It also found that sub-prime borrowers in states with strong laws received fewer loans with abusive terms.⁸

Information and resources

Colorado Attorney General's Office, Consumer Protection Division.

🔗 www.ago.state.co.us

"Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado's Deferred Deposit Loan Act," Paul Chessin, University of Denver Law Review, Vol. 83:2, Nov. 16, 2005.

🔗 www.law.du.edu/lawreview/issues/83_2/Chessin_83_2.pdf

"The Best Value in the Sub-prime Market: State Predatory Lending Reforms," Wei Li and Keith Ernst, Center for Responsible Lending, Feb. 23, 2006.

🔗 www.responsiblelending.org/pdfs/rr010-State_Effects-0206.pdf

"Predatory Mortgage Lending," National Conference of State Legislatures.

🔗 www.ncsl.org/programs/banking/predlend_intro.htm

"Payday Lending," National Conference of State Legislatures.

🔗 www.ncsl.org/programs/banking/paydaylend_intro.htm#Articles

"Financial Quicksand: Payday lending sinks borrowers in debt with \$4.2 billion in predatory fees every year." Uriah King, Leslie Parrish and Ozlem Tanik, Center for Responsible Lending, North Carolina, Nov. 30, 2006.

🔗 www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf

Payday Lending Prohibition Act model legislation, Center for Policy Alternatives, Washington, D.C.

🔗 www.cfpa.org/issues/legislation.cfm/issue/PaydayLending.xml

John Warner National Defense Authorization Act for Fiscal Year 2007, S. 2766, Section 666.

🔗 www.govtrack.us/data/us/bills.text/109/h/h5122.pdf

Georgia payday lending statute, Title 16-17-1 of the Georgia Code.

🔗 www.legis.ga.gov/legis/GaCode/?title=16&chapter=17§ion=1



North Carolina anti-predatory mortgage lending act, Chapter 24 of the North Carolina Statutes.

www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_24/GS_24-1.1E.html

End notes

¹ Association of Community Organizations for Reform Now (ACORN). (2002). A Dreamed Deferred: Predatory Lending in Colorado.

www.acorn.org/index.php?id=137

² New Jersey mortgage law.

www.njleg.state.nj.us/2002/Bills/PL03/64_PDF

New Mexico mortgage law.

<http://rld.state.nm.us/fid/PDFs/Home%20Loan%20Protection%20Act.pdf>

Texas mortgage laws.

<http://tlo2.tlc.state.tx.us/statutes/fi.toc.htm>

<http://tlo2.tlc.state.tx.us/statutes/gvtoc.html>

North Carolina anti-predatory mortgage lending act, Chapter 24 of the North Carolina Statutes.

www.ncga.state.nc.us/EnactedLegislation/Statutes/HTML/BySection/Chapter_24/GS_24-1.1E.html

³ “Attorney General’s Office Releases Annual Lending Data,” Colorado Department of Law, Sept. 25, 2006.

www.ago.state.co.us/press_detail.cfm?pressID=808

⁴ Borrowing from Peter to Pay Paul: A Statistical Analysis of Colorado’s Deferred Deposit Loan Account, Paul Chessin, University of Denver Law Review, vol. 83:2, Nov. 16, 2005.

⁵ Georgia payday lending statute, Title 16-17-1 of the Georgia Code.

<http://www.legis.ga.gov/legis/GaCode/?title=16&chapter=17§ion=1>

Maryland Code Annotated Commercial Law II section 12-301 to 12-317

Massachusetts General Law Annotated, Chapter 140, Sections 90 and 96.

<http://www.mass.gov/legis/laws/mgl/140-90.htm>

<http://www.mass.gov/legis/laws/mgl/140-96.htm>

⁶ John Warner National Defense Authorization Act for Fiscal Year 2007, S. 2766, Section 666.

www.govtrack.us/data/us/bills.text/109/h/h5122.pdf

⁷ These recommendations are based on research by Paul Chessin, Colorado assistant attorney general, who represents the administrator of the Colorado Uniform Consumer Credit Code and enforces the Deferred Deposit Loan Act (payday lending act).

⁸ “The Best Value in the Subprime Market: State Predatory Lending Reforms,” Wei Li and Keith Ernst, Center for Responsible Lending, Feb. 23, 2006.