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PAYDAY LENDING STATUTES: A STATE-BY-STATE COMPARISON

INTRODUCTION

The payday loan industry was the subject of bills during the 2004, 2005 and 2006 legislative sessions and of a governor's task force convened during the 2005 interim. One proposal in 2006 made it through the House and two Senate committees only to die on the floor of the Senate in the last hours of the session. The Financial Institutions Division (FID) of the Regulation and Licensing Department has promulgated rules pursuant to the New Mexico Small Loan Act of 1955 to regulate the payday loan industry. This bulletin provides background information on how other states regulate the payday loan industry, summarizes the new FID rules and poses policy considerations for New Mexico legislators.

TWO EXTREMES

When it comes to regulating payday loans,[1] the extreme approaches are either to ban the industry completely or to permit the industry to operate without state regulation. Since the repeal of New Mexico's general usury statutes, payday lending in New Mexico has essentially been unregulated by the state. The other state that does not significantly regulate the payday loan industry appears to be Wisconsin. Although 10 states do not specifically regulate the payday loan industry, they may implicitly ban payday lending through interest rate caps (usury laws) that make payday loans economically infeasible. Only Georgia and West Virginia have specifically banned the payday loan industry.[2] Thirty-six states specifically regulate the payday loan industry.

CRITICAL CRITERIA

In looking at the regulatory framework imposed on the payday loan industry in other states, there are a number of critical characteristics that dramatically affect the impact of those laws. The following sections review those critical criteria and show the range of restrictions imposed by those states.

LOAN AMOUNTS

Most states regulating payday loans impose a cap on the amount of payday loans that can be incurred by a consumer. States differ on whether such caps are on the total amount that can be borrowed by a consumer, or whether caps apply only to the amount of a single transaction or the amount that can be loaned by a single lender. Single-transaction caps range from $300 to $800. Limits on the amount that can be loaned by any one lender range from $300 to $1,000. Some states impose limits only on the total amount that can be borrowed by a consumer, and those limits are expressed either in dollar amounts (from a maximum of $300 to $1,000) or as a percentage of income (25 percent of net monthly income to 25 percent of gross monthly income). Several states combine these caps in different ways. Three states impose a minimum loan amount of $50.00.

[1] "Payday loans" refers to loans in which a lender accepts a personal check or debit authorization from a consumer and agrees to defer presentment of that check or use of the debit authorization until the consumer's next payday or another agreed-upon date.

[2] In Georgia, payday lending is declared by statute to be a public nuisance.

NUMBER OF LOANS

A majority of the states regulating payday loans impose a limit on the number of loans that can be incurred by a consumer. The limit may be either on the number of loans from a single lender (ranging from one to three loans) or on the total number of loans a consumer may have at one time (either one or two loans) or within a specified time period.

VERIFICATION

Whenever there is a limit on the number or amount of payday loans that may be entered into by a consumer at one time, the question of verification arises. How is a lender to know whether a requested loan will exceed the statutory limits on the number or amount of payday loans? A majority of the states do not address this issue, thereby putting lenders at risk of unknowingly violating loan restrictions. Other states simply require the consumer to certify the number and amount of outstanding payday loans and the consumer's gross or net monthly income. While such a certification may protect the lender from penalties for violating loan restrictions, there is no assurance that the consumer's certification is accurate. Seven states provide for a mandatory electronic, real-time database that can be used to verify a consumer's eligibility for a payday loan.

FEES

Perhaps the characteristic of payday loans with the highest profile is the fees incurred for such loans. Permitted fee structures vary greatly from state to state. Some states impose a flat limit on fees ranging from 10 percent to 25 percent of the principal amount of the loan. Other states have a sliding scale of permitted fees with a reduced percentage applying to loan proceeds in excess of specified benchmark amounts. Several states permit a lender to impose an administrative fee in an amount of $5.00 to $20.00 in addition to a percentage of the loan amount. Two states impose fee caps of $30.00 and $45.00 per loan. Two states calculate their rate caps as a monthly interest rate, specifying five percent and 20 percent of the loan amount. One state permits fee restrictions to be automatically adjusted according to periodic changes in the consumer price index. Some states provide for a much lower interest rate on amounts remaining due after maturity. Statutes in several states specifically provide that the fees are not interest and are fully earned at the time the loan is entered into. Most states expressly permit lenders to charge a fee ranging from $10.00 to $30.00 for checks that are returned unpaid, although some states allow only one such charge per loan. Many states specifically prohibit additional fees or penalties when a consumer pays off a loan prior to maturity.

TERM OF LOANS

One of the most contentious aspects of payday loans is the term of the loan. As evidenced by the common name given to these transactions, "payday" loans are intended to be short-term loans with repayment on the consumer's next payday. Paydays are often scheduled on a weekly, bi-weekly or monthly basis.

Nineteen states have maximum loan periods of 30, 31 or 32 days or one month; six states have maximum loan periods of 40, 45 or 60 days. The shortest maximum loan period is seven days and the three longest maximum loan periods are 12 weeks, 120 days and six months. Four of the states with statutory regulatory schemes have no maximum loan period. Thirteen states specify minimum loan periods ranging from five to 14 days.

RENEWALS

The "cycle of debt" problem is the focus of much criticism by consumer advocates. A major component of this problem is the ability of a consumer to renew a payday loan on a continuing basis without having to pay any portion of the loan principal. Eleven states prohibit a lender from renewing a payday loan. Five states permit only one renewal while seven states permit two, three, four or six renewals of a payday loan. Several states permit payday loans to be renewed or extended at no extra cost to the consumer.

Payment Plans

Several states provide for payment plans when a consumer is unable to repay a loan in full at the end of the term of an initial or renewed payday loan. In some states, the payment plan is mandatory; in other states, the payment plan may be optional at the discretion of either the consumer or the lender. Payment plans vary widely in their terms and include four equal monthly installments and payment periods ranging from 55 days to six months. States also differ as to whether there is an initial charge to enter into a payment plan and what rate of interest, if any, can be charged on unpaid principal during the payment period. Florida requires a lender to give a consumer a 60-day grace period following a default, during which time the consumer must undergo credit counseling.

Waiting Periods

Nine states impose some form of waiting period to limit the ability of a consumer to enter into new payday loans. The length of the waiting period ranges from the next business day to 15 days. The trigger for the imposition of a waiting period varies from state to state, but includes the following: payment of a prior payday loan, renewal(s) of a payday loan, participation in a payment plan, a specific number of consecutive payday loans and a specific number of days in which a consumer has obligations under payday loan agreements. One state limits a consumer to three loans per lender within 30 days.

Enforcement and Penalties

All states restricting the payday loan industry have one or more means of enforcing those restrictions. The most common means of enforcement is through the suspension or revocation of state licenses that permit a lender to engage in payday lending in that state and the issuance of cease and desist orders by the state regulator. Twenty-two states permit the licensing authority to impose administrative fines ranging from $500 to $10,000 per violation. Some states also permit the recovery of the state's cost of investigation. Nine states explicitly provide for a private right of action enabling a consumer to bring a lawsuit against a lender for alleged statutory violations. In such cases, a consumer often may recover actual or treble damages and attorney fees, and, in some states, statutory damages up to $1,000. Several states declare a violation of payday lending restrictions to be a violation of the state's consumer protection or unfair trade practices act. In 16 states, violation of the restrictions on payday loans exposes a lender to criminal liability for a misdemeanor or a felony, with the possibility of a maximum fine of $10,000 and a year in jail for lending without a license. In several states, if a lender charges excessive fees, the loan is void and the lender cannot collect unless the excessive charges are a result of a "bona fide" clerical or computer error.

Other Provisions

Seventeen states have enacted provisions that permit a consumer to rescind a payday loan agreement. Many states require such a right to be exercised before the end of the following business day and require all fees to be refunded in full to the consumer. Some states specify that payday loans cannot be divided into more than one loan in order to charge higher fees in cases of sliding fee scales. One state requires the responsible administrative agency to report annually to the legislature regarding payday loan activity.

New Mexico Rules

The payday lending rules published by the FID on August 15, 2006 have a general effective date of August 31, 2006. The total amount borrowed cannot exceed 25 percent of the consumer's gross monthly income, but there is no limit on the number of payday loans a consumer can have outstanding at any one time. A verification database will be available no later than November 30, 2006. Administrative fees for payday loans are capped at $15.50 per $100 of principal; no interest charges are permitted. Payday loans cannot have a term less than 14 days or more than 35 days. A consumer has the right to rescind a payday loan at no cost until

5:00 p.m. on the first business day following the loan. A consumer has the right to renew a payday loan twice, and can elect that option up to 14 days after the due date of the loan. At any time until 28 days after the due date of a loan that has been twice renewed, a consumer has the right to enter into a loan payment plan at no additional cost. The payment plan must be at least 130 days in length. If within the prior 12 months a consumer has had payment obligations under a payday loan product for 60 consecutive days or a total of 90 or more days, a consumer must have completed all payment obligations for all payday loan products for at least seven days. Violation of the rules may result in the administrative suspension or revocation of a payday lender's license, which license is required pursuant to the New Mexico Small Loan Act of 1955.

CRITICAL CHOICES

An important element of a payday loan regulatory scheme is whether to prohibit or limit the cycle of debt. The problem arises when a consumer is able to enter into successive payday loans, thereby incurring high amounts of interest charges without ever reducing the principal amount borrowed. It is this scenario that can lead to the horror stories of people repaying lenders amounts greatly in excess of the amount originally borrowed.

Regulatory approaches that may limit this problem include the following: 1) prohibit or limit the renewal of payday loans; 2) prohibit the repayment of a payday loan with the proceeds of a new payday loan from a different lender; 3) prohibit multiple payday loans by a consumer, either entirely or when a consumer exceeds a threshold limit on payday loan activity; 4) require lenders to offer consumers an option to repay a payday loan over an extended period at reduced interest rates; and 5) impose waiting periods between payday loans, during which time a consumer may have no payday loan obligations.

FINAL COMMENTS

Public and legislative concerns for the impact of the payday lending industry on consumers have over the past few years generated much debate and many legislative proposals across the country. Forty states have adopted statutes addressing payday lending. In 2006, a total of 85 bills were introduced in 25 states to amend or enact laws regulating the payday loan industry. Close attention should be paid to recent legislative enactments and to state administrative regulations when attempting to gain an overview of state efforts to regulate the payday loan industry. A great deal of attention has also been focused recently on lending practices for car title and tax refund loans, and increased regulation of these industries may be forthcoming as well.

In considering how to regulate the payday loan industry, several fundamental questions must be addressed. First, is the objective to ban the industry by capping interest rates at a level to make payday loans unprofitable, or is there a commitment to determine the range of interest rates that will permit a fair rate of return on investment by those in the industry? Second, is the traditional business model of "payday" loans acceptable, or does the model need to be changed to extend the minimum term of a payday loan beyond the consumer's next payday? Finally, if the conventional payday loan business model is no longer available to New Mexicans, what will be the consequences of that policy decision? Will consumers turn to unregulated "black market" lenders? Will they travel to payday lenders situated just across the border in adjoining states with payday loan transactions being regulated by the decisions of other state legislatures? Will consumers turn to out-of-state lenders doing business via the Internet?

This Information Bulletin does not represent a policy statement of the Legislative Council Service or its staff. This Information Bulletin was written by Chase Van Gorder. For more information, contact the Legislative Council Service at (505) 986-4600.

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