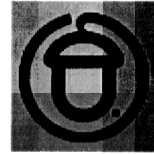


GONE TO TEXAS COALITION*



TexPIRG

TEXAS IMPACT
people of faith working for justice



August 17, 2005

The Honorable Leslie Pettijohn
Consumer Credit Commissioner
Office of the Consumer Credit Commissioner
2601 North Lamar Boulevard
Austin, Texas 78705

Re: Regulating Payday Lenders

Dear Ms. Pettijohn:

Given recent changes in the business model used by the largest players in the Payday loan industry, the organizations listed below urge you to request the Attorney General to take enforcement action against these companies for violation of the state's usury laws. We hope to raise this issue before the Texas Finance Commission at its meeting on Friday, August 19th.

As you know, the majority of large Payday lenders operating in Texas changed their business model this summer. Before this change, all of the large Payday loan operators avoided Texas usury law by brokering such loans with financial institutions located in states like Delaware and South Dakota that have no interest rate limits. Texas law arguably did not apply to such loans, because the lenders listed on the loan documents were merely exporting the interest rates permitted in their home states, a practice authorized by federal law. In fact, federal law may well have preempted states from even attempting to regulate the interest portion of such loans. Since the companies operating in Texas who originated the loans for the out-of-state banks assumed all of the risk of default in these transactions, the business model was referred to as "charter-renting." This name accurately recognizes that the originators may well be the true lenders in these transactions.

The charter-renting business model became progressively more difficult as the Comptroller of the Currency, the Office of Thrift Supervision, and other federal regulatory agencies prohibited their member banks from participating in this practice. These administrative actions meant that the only remaining banks involved in Payday lending were state-chartered institutions regulated on the federal level only by the Federal Deposit Insurance Corporation. This spring, however, the FDIC announced that these institutions could only make six Payday loan transactions per year per customer. Since most Payday loans are renewed nine or 10

**Many early American settlers struggling with debt etched "Gone to Texas" on their doors when they moved to the Republic for the chance to escape lenders and rehabilitate.*

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times before being paid off, this FDIC ruling makes use of the old charter-renting model far less lucrative for the companies that originated these loans.

Recognizing the new difficulties associated with the old charter-renting business model, all but one of the major Payday loan companies operating in Texas have decided to adopt a new business model, which they hope immunizes them from Texas usury law. Under the new business model, these companies have registered as credit services organizations under the Credit Services Organizations Act (CSOA), Tex. Fin. Code § 393.001 *et seq.*, and they assert that by acting as loan brokers registered under the CSOA that their fees should therefore not be treated as interest under Texas usury law.

This new business model relies upon the ruling of the U.S. Fifth Circuit Court of Appeals in *Lovick v. Ritemoney*, 378 F.3d 433 (5th Cir. 2004), which held that the CSOA impliedly repealed portions of Texas usury law. In *Lovick*, the Fifth Circuit was interpreting state law. In our judgment, the Fifth Circuit got state law wrong. The CSOA did not expressly repeal the state's usury laws, and nothing in the legislative history suggests that the Legislature intended to do so. The first time a state court confronts whether the CSOA impliedly repeals the state's usury laws, we expect the state court will reject *Lovick* and hold that it does not.

Likewise, we urge you to reject *Lovick* and refer any CSO charging usury through Payday loan "fees" to the Attorney General for enforcement of the state's usury laws. If you successfully challenge the new business model in court, Texas' usury laws will apply to the Payday loan industry for the first time in a number of years. On the other hand, if you fail to challenge the new business model, the entire edifice of Texas usury law in consumer transactions will crumble. Given the deep roots of usury law in the history of this state, and the Legislature's recent refusal to deregulate the Payday loan industry, we urge you to take action now to challenge Payday lenders' use of the CSO business model in state court.

Sincerely yours,

Celia Hagert
Don Baylor
Senior Policy Analysts
Center for Public Policy Priorities

Bee Moorhead, Executive Director
Texas Impact

Luke Metzger
Advocate
TexPIRG

Texas ACORN
(Texas Association of Community
Organizations for Reform Now)

cc: Greg Abbott, Attorney General of Texas
David Mattox, Assistant Attorney General
Chief, Financial Litigation
Office of the Attorney General of Texas