



POLICY ALERT

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HB 846 is A Wolf in Sheep's Clothing: Legislation Claims to "Regulate" Payday Lenders, But Actually Raises Interest Rates and Fails to Close Critical Loophole

House Financial Institutions Committee to Vote on Bill Monday, April 4th

What is a Payday Loan?

A payday loan is a short-term, high-interest loan that some low-income Texans rely on when they have trouble paying their bills between paychecks. These storefront lenders charge exorbitant interest rates—sometimes as high as 800 percent—in addition to high “rollover” fees that extend the loan when borrowers can't repay it on time. Payday loans take advantage of low-income families desperate for fast cash and can trap borrowers in a spiral of debt.

Background

Current Texas law and the Office of Consumer Credit regulate the interest rates charged by payday lenders (see http://www.occ.state.tx.us/pages/int_rates/342Frates.pdf for current rates). For example, the cap on fees charged for an average 14-day, \$200 loan is \$13.73, equivalent of 178% APR. In practice, however, payday lenders ignore these caps, charging as high as 880% for a loan of the same amount.¹ Dubbed the “rent-a-bank” arrangement, payday lenders in Texas and other states evade their home states' usury laws by exporting the rates of out-of-state banks in states with lax or no usury laws. Over a thousand payday outlets in Texas use out-of-state bank arrangements to charge higher rates than Texas rules allow. Of the payday loans reported to the OCC in 2000, 13,178 (less than 4% of total loans) were made by registered in state lenders (totaling \$2,753,374), but another 353,903 were payday loans made through out of state banks.² Ideally, Congress should step in to stop federally insured banks from renting their rate exportation authority to payday lenders. In the meantime, several states have enacted legislation to close these loopholes.

HB 846

Representative Dan Flynn has introduced industry-backed legislation that claims to regulate payday lenders. The proposed legislation does include several well-intended provisions—broad disclosure, licensing requirements, limited loan renewals, and a payment plan option—that will prevent payday lenders from violating certain aspects of Texas' payday lending law. Ultimately, though, the bill does more harm than good. Most notably, HB 846 **raises** the cap on interest rates to \$15/\$100 loan, the equivalent of 390% APR—almost one-third higher than the cap allowed under current law—and fails to ban the exportation of out-of-state rates. Enacting legislation without a rate exportation ban would maintain the current loophole that allows lenders to sidestep the state usury cap. Further, as drafted, HB 846 would render the Office of Consumer Credit powerless to enforce penalties against lenders that exceed the \$15 per \$100 provision. The industry opposes a rate exportation ban, which casts

¹ Consumers Union, “Payday Lenders Continue to Ignore State Laws Related to Fees and Protections,” Austin, Texas, July 2003. Press release available at http://www.consumersunion.org/pub/core_financial_services/000203.html.

² Consumers Union, “Payday Lenders Burden Working Families and the Armed Forces,” Austin, Texas, July 2003, <http://www.consumersunion.org/pdf/payday-703.pdf>. **Note:** Since current law does not require payday lenders to register with the OCC, these data represent only a fraction of the actual volume of payday lending in Texas.

doubts on both their motives for supporting this legislation as well as their promise to comply with the higher rates should they be adopted. In a nutshell, the bill does little to prevent lenders from exploiting the cash-strapped families who use these loans.

So, why does the payday industry support this legislation?

The industry invites such “regulation” in order to lock in higher interest rates than are allowed under current Texas law for fear that the FDIC will put an end to the “rent-a-bank” relationship that enables payday lenders to partner with its banks to evade state usury laws. Although federal law allows a bank to charge in every state the interest rates allowed in its home state, the Federal Office of the Comptroller of the Currency (OCC) and the Federal Reserve recently severed ties between the banks they supervise and storefront payday lenders who claim the banks' rights to export home-state interest rates and to preempt state laws. The FDIC has indicated in guidance to its banks that such practices also should be curtailed because they are bad for banks as well as consumers, but it has yet to take action and continues to permit its banks to partner with payday lenders (see <http://www.fdic.gov/news/news/press/2003/pr7003.html> for FDIC press release and guidance).

So, why won't Texas ban the “rent-a-bank” arrangement?

Given the prevalence of “rent-a-banks” in payday lending—eleven of the thirteen largest payday loan chains partner with ten state-chartered FDIC banks to make loans they cannot legally make on their own—the best way for Texas to protect consumers against usurious payday loans is to prohibit payday lenders from partnering with out-of-state banks in order to evade our strict usury laws. Because of the threat of federal preemption, however, Texas is wary of passing such a ban, despite recent court decisions that have upheld other states' laws prohibiting payday lenders from partnering with out-of-state banks. Instead, HB 846 attempts to persuade payday lenders not to export out-of-state bank rates by capping the interest charged on these loans at a much higher rate than is allowed under current state law, but at a lower rate than is exported under a rent-a-bank arrangement. However, consumer rights groups argue that the Texas legislature has the statutory right and the duty to enforce its own laws and protect consumers from usurious interest rates. Until Texas is ready to take on this challenge and defend its laws against a preemption charge, the legislature should not pass “regulation” that provides for a higher fee structure than is allowed under current law.

What's next?

HB 846 can be viewed and downloaded from the legislature's web site at www.capitol.state.tx.us. There is no companion bill in the Senate. HB 846 had a hearing in the House Financial Institutions Committee in March and was left pending. On Monday, April 4, the committee is likely to vote whether to pass the bill. The hearing will begin at 2 p.m. or upon adjournment of the House in the capitol extension, room E2.012.

How do I find out more about HB 846 and payday lending?

- CPPP's testimony on HB 846 is on our web site at <http://www.cppp.org>.
- For more background on payday lending visit the following websites:
 - 1) The Center for Responsible Lending at <http://www.responsiblelending.org/payday/index.cfm>
 - 2) The Consumer Federation of America at <http://www.consumerfed.org/>
 - 3) The National Consumer Law Center at http://www.nclc.org/initiatives/payday_loans/index.shtml
 - 4) Consumers Union at http://64.224.99.117/i/Financial_Services/Pay_Day_Loans/index.html