Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 474 (Substitute S-4 as reported)
Sponsor: Senator Valde Garcia
Committee: Economic Development, Small Business and Regulatory Reform

Date Completed: 6-30-03

RATIONALE

The deferred presentment service industry, also known as payday lending or check advance, has experienced considerable growth in recent years. According to the National Conference of State Legislatures (NCSL), the number of payday loan offices grew from virtually zero to more than 10,000 in the United States during the 1990s. Designed for individuals who find themselves temporarily short of cash, payday advances are short-term loans of relatively small amounts based on a personal check held for future deposit. Typically, a consumer will write a check, dated a week or two in the future, for the loan amount plus a finance charge. At the end of the loan period, the borrower can redeem the check with cash or a money order, or renew the loan and pay an additional fee. Otherwise, the lender will deposit the check.

Evidently, this service can be financially damaging to some borrowers. The fee that payday lenders charge usually is about $15 to $20 on a $100 loan, and a consumer pays the fee each time he or she renews a loan. Apparently, it is not uncommon for borrowers to renew their loans a number of times. An article in *Governing* (December 2000), for example, reported that a study by the Indiana Department of Financial Institutions found that the average borrower in Indiana renewed his or her loan over 10 times before paying off the principal in full.

The State of Michigan does not regulate this industry, and there are no restrictions on the fees that payday lenders may charge, the number of outstanding loans a borrower may have, or the number of times a borrower may renew a loan. Many people believe that regulation of these practices is necessary to provide consumer protection.

CONTENT

The bill would create the "Deferred Presentment Services Act" to do the following:

-- Prohibit a person from engaging in the business of providing deferred presentment services without a license from the Commissioner of the Office of Financial and Insurance Services (OFIS).
-- Require the Commissioner to establish license fees sufficient to cover OFIS's administrative costs.
-- Require a licensee to document a deferred presentment service transaction by entering into a deferred presentment services agreement with the customer.
-- Limit a deferred presentment services agreement to a maximum of $1,000 and 31 days.
-- Allow a licensee to charge a service fee of up to 18% of the amount paid to a customer.
-- Require a licensee to display certain notices, and to include other notices in a services agreement.
-- Allow a customer to complain to a licensee of a violation and/or file a complaint with the Commissioner, and require the Commissioner to investigate a customer's complaint.
-- Authorize the Commissioner to issue a cease and desist order, suspend or revoke a license, and impose civil fines.

"Deferred presentment service" would mean a transaction between a licensee and a customer under which the licensee agreed to pay to the customer an agreed-upon amount in exchange for a fee, and to hold one or more of the customer's checks for a period of time before negotiation, redemption, or presentment of

the checks. A "customer" would be an individual who inquired into the availability of a deferred presentment service and/or entered into a deferred presentment services agreement.

The bill would take effect July 1, 2004.

Licensing

Application. The bill would prohibit a person from engaging in the business of providing deferred presentment services without a license. A separate license would be required for each location from which deferred presentment services were conducted.

A license applicant would have to have and maintain net worth of at least $50,000 for each licensed location, subject to a maximum of $250,000 in required net worth for any one licensee. Further, the person would have to demonstrate to the Commissioner that the applicant had the financial responsibility, financial condition, business experience, character, and general fitness reasonably to warrant a belief that the applicant would conduct its business lawfully and fairly. In determining whether this requirement was satisfied, and for the purpose of investigating compliance with the bill, the Commissioner could review the applicant's relevant business records and capital adequacy; the competence, experience, integrity, and financial ability of any person who was a member, partner, director, or officer, or a shareholder with 25% or more interest in the applicant; and any record regarding any of those people or the applicant of any criminal activity, fraud, or other act of personal dishonesty, an act, omission, or practice that constituted a breach of a fiduciary duty, or any suspension, removal, or administrative action by any agency or department of the United States or any state. Upon receiving a license application, the Commissioner would have to investigate to determine whether the qualifications had been satisfied and, if so, issue to the applicant a license to engage in the deferred presentment services business.

Each license application would have to include identifying information specified in the bill; the location of the applicant's registered office; and other data and information the Commissioner required with respect to the applicant, its directors, officers, members, shareholders, managing employees, or agents.

If the Commissioner determined that an applicant was not qualified to receive a license, he or she would have to give the applicant written notice that the application had been denied, stating the basis for denial. If the Commissioner denied an application, or failed to act within 60 days after a properly completed application was filed, the applicant could submit a written demand to the Commissioner for a hearing on the question of whether he or she should grant a license. If a hearing were held, the Commissioner would have to reconsider the application and issue a written order granting or denying it.

License Fees; Bond. A licensee would have to pay a license fee, in an amount determined by the Commissioner, within 60 days of submitting its license application, and then annually. Each year, the Commissioner would have to establish a schedule of license fees based upon each licensee's business volume, number of locations, and any other business factors he or she considered reasonable in order to generate funds sufficient to pay, but not to exceed, OFIS's reasonably anticipated costs of administering the bill. A licensee would have to pay the actual travel, lodging, and meal expenses incurred by office employees who traveled out of State to investigate the licensee or examine its records. Money received under the bill would have to be deposited in the State Treasury and credited to OFIS for its operations.

A licensee also would have to furnish a $50,000 surety bond to secure the performance of its obligations, issued by a bonding company authorized to do business in the State, in a form satisfactory to the Commission.

General Licensure Provisions. A licensee would have to post a copy of its license in a conspicuous location at its place of business.

After a license was issued, it would remain in effect through September 30, unless surrendered, suspended, or revoked. A license would expire September 30 each year. A licensee could renew a license for a year by submitting an application that showed continued compliance with the bill, and paying the renewal fee.

A license would not be transferable or assignable. The Commissioner's prior written approval would be required for the continued operation of a deferred presentment services

business if there were a change in control of the licensee. The Commissioner could require information considered necessary to determine whether a new application was required. The person who requested the approval would have to pay the cost incurred by the Commissioner in investigating the change in control request. A licensee would have to notify the Commissioner five days before any change in the licensee's business location or name. (Under these provisions, "control" would mean either: 1) for a corporation, direct or indirect ownership, or the right to control, 25% or more of its voting shares, or the ability of a person to elect a majority of the directors or otherwise effect a change in policy; or 2) for any other entity, the ability to change the principals of the organization, whether active or passive.)

Reports. Within 15 days after any of the following events occurred, a licensee would have to file with the Commissioner a written report describing the event and its expected impact on the licensee's activities: the filing for bankruptcy or reorganization by the licensee; the institution of revocation or suspension proceedings against the licensee by any state or governmental authority; any felony indictment or conviction of the licensee or any of its members, directors, officers, or shareholders; and any other events the Commissioner determined and identified by rule.

Existing Business. A person conducting a deferred presentment services business in this State on the bill's effective date could continue to conduct that business until the Commissioner acted upon its application. During that period, the person would have to comply with the bill's requirements concerning notices, deferred presentment services agreements, limitations on transactions, payment, complaints, and violations.

Deferred Presentment Services Agreement

Notice. The bill would require a licensee to post a notice prominently in an area designed to be seen by a customer before he or she entered into a deferred presentment services agreement. The notice would have to be in at least 32-point type and contain a statement prescribed in the bill. The statement, in part, would have to inform the customer that the licensee could defer cashing his or her check only for up to 31 days; the licensee could not enter into a transaction if the customer already had a deferred presentment services agreement in effect; the customer could cancel an agreement; the licensee could not renew an agreement for a fee; and the customer was entitled to information about filing a complaint against the licensee. The licensee also would have to post prominently, in at least 32-point type, a schedule of fees and charges imposed for deferred presentment services.

Content. A licensee would have to document a deferred presentment service transaction by entering into a written deferred presentment services agreement signed by both the customer and the licensee. A licensee would have to include all of the following in the agreement

-- The customer's name; the licensee's name, street address, and telephone number; and the date of the agreement.
-- The signature of the individual who entered into the agreement on behalf of the licensee.
-- The amount of the check presented to the licensee by the customer.
-- An itemization of the fees and interest charges to be paid by the customer and a clear description of his or her payment obligation under the agreement.
-- A schedule of all fees and charges associated with the transaction, and an example of the amounts the customer would pay based on the amount of the transaction.
-- The maturity date.
-- The licensee's agreement to defer presentment, defer negotiation, or defer entering the check into the check-clearing process until the maturity date.
-- A description of the process a customer could use to file a complaint against the licensee.

The agreement also would have to include, in at least 12-point type, a notice prescribed in the bill. The notice would have to include information similar to that contained in the posted notice.

At the time of entering into a deferred presentment service agreement, a licensee would have to give a copy of the signed agreement to the customer.

Limitations. A licensee could enter into a deferred presentment services agreement with a customer for any amount up to $1,000, plus

a service fee. A licensee could charge a service fee for each deferred presentment service transaction, not to exceed 18% of the amount paid by the licensee to the customer. A service fee would be earned by the licensee on the date of the transaction and would not be considered interest.

At the time of entering into an agreement, a licensee could not charge interest; include a maturity date that was more than 31 days after the date of the agreement; charge an additional fee for cashing the licensee's business check if the licensee paid the proceeds to the customer by business check; include a confession of judgment in the agreement; or charge or collect any other fees for a deferred presentment service, except as provided in the bill.

A licensee could not renew an agreement, but could extend it if the licensee did not charge a fee in connection with the extended transaction. The licensee could not create a balance owed above the amount owed on the original agreement.

Conditions. A licensee could not enter into an agreement with a customer if he or she had a deferred presentment services agreement that had not been fully repaid with the licensee or with any other licensee. In determining whether this was the case, the licensee would have to obtain a written representation from the customer, and verify independently the accuracy of that representation through commercially reasonable means. A customer who entered into an agreement in violation of these provisions would not be entitled to the remedies provided under the bill or through OFIS with regard to that agreement.

Notice. At the time of entering into a deferred presentment services agreement, a licensee would have to give the customer a notice in a document separate from the agreement. This notice would have to inform the customer of the procedures that would apply if he or she believed that the licensee had violated the law.

Satisfaction. A customer would satisfy his or her obligation under an agreement when a financial institution paid the check the licensee was holding or the customer redeemed the check by paying the licensee an amount equal to the full amount of the check. If the customer satisfied his or her obligation under an agreement, the licensee or any other licensee could enter into a new agreement with that customer.

Document Retention. A licensee would have to maintain each deferred presentment services agreement until two years after the date it was satisfied, and make available for examination by the Commissioner all agreements and related documents in its possession or control including any applications, credit reports, employment verifications, or loan disclosure statements. A licensee also would have to preserve and keep available for examination all documents pertaining to a rejected application for a deferred presentment service for any period of time required by law.

Rescission or Redemption

A customer could rescind a deferred presentment services agreement without cost to him or her and for any reason if the customer, by the close of business on the business day following the date of the agreement, delivered to the licensee cash or a cash equivalent in an amount equal to the amount of cash the customer received. The licensee would have to return to the customer the check received under the agreement and any service fee paid by the customer. The customer would not be eligible for restitution with regard to the rescinded agreement.

A customer could redeem a check from the licensee at any time before the maturity date. The licensee would have to return the check upon receiving cash or its equivalent in the full amount of the check. A licensee could not contract for or collect a charge for accepting partial payments from the customer if the full amount were paid by the maturity date.

Payment & Presentment

At the time of entering into a deferred presentment services agreement, a licensee would have to pay the proceeds under the agreement to the customer in cash, if requested. Otherwise, the licensee could pay the proceeds to the customer in the form of the licensee's business check, money order, cash, or any other valid method of monetary transfer.

A licensee would be prohibited from presenting a check for payment before the maturity date. A licensee that did so would be liable for all expenses and damages caused to

the customer and the financial institution upon which the check was drawn as a result of the violation, in addition to the remedies and penalties provided in the bill.

Before negotiating or presenting a customer's check for payment, a licensee would have to endorse it with the actual name under which the licensee was doing business.

A licensee could contract for and collect a returned check charge that did not exceed $25, if one or more of a customer's checks that the licensee was holding under an agreement were returned by a financial institution due to insufficient funds, a closed account, or a stop payment order. The licensee could contract for and collect only one returned check charge in a transaction with a customer. A licensee also could exercise any other remedy available under any law applicable to the return of a check because of a closed account or a stop payment order.

A customer would not be subject to any criminal penalty for entering into an agreement and would not be subject to any criminal penalty in the event his or her check was dishonored.

Violations/Complaints

Complaint to Licensee. A customer who believed that a licensee had violated the bill could notify the licensee in person, by the close of business on the day he or she signed an agreement. Also, at any time before signing an agreement, a customer who believed that a licensee had violated the bill could give the licensee a written notice of the licensee's violation. In either case, the customer would have to identify the nature of the violation and include documentary or other evidence in the notice. By the close of the third business day after receiving a notice, the licensee would have to determine if it had violated the law as alleged in the notice.

If the licensee determined that it had violated the law, it would have to return to the customer the check received under the agreement, and any service fee paid by the customer. The customer would have to deliver to the licensee cash or a cash equivalent in an amount equal to the amount of cash the customer received under the agreement. In addition, the licensee would have to make restitution to the customer for each violation in an amount equal to five times the amount of the fee charged in the customer's agreement, but not less than $15 or more than the face amount of the check. A licensee that made restitution for a violation would not be subject to any other remedy provided for a violation under the bill with respect to that violation. The licensee immediately would have to notify the Commissioner that it made restitution, and give detailed information about the terms of the agreement as well as other information requested by the Commissioner.

If the licensee determined that it did not violate the law, it immediately would have to notify the Commissioner and the customer of that determination. The licensee would have to give the Commissioner detailed information about the terms of the agreement and provide other information requested by the Commissioner. The licensee would have to include in the notification to the customer that he or she had the right to file a written complaint with OFIS if he or she did not agree with the licensee's determination. The licensee also would have to include in the notice detailed information on how the customer could contact OFIS to obtain a complaint form. The customer then could file a written complaint with OFIS on a form prescribed by the Commissioner. The customer would have to include with the complaint documentary or other evidence of the violation.

If the licensee had otherwise complied with the bill and determined that it did not violate the law, the licensee could present the check for payment on or after the maturity date. If the check were not honored, the licensee could initiate any lawful collection effort.

The Commissioner promptly would have to investigate a complaint filed by a customer under these provisions. If he or she concluded that the licensee committed a violation, the Commissioner could order the licensee to make restitution to the customer in an amount equal to 15 times the amount of the fee charged in the customer's agreement, but not less than $45 or more than three times the full amount of the check. The licensee also would be subject to any other applicable penalties and remedies available under the bill.

Complaint to OFIS. A customer could file a written complaint with OFIS, on a form prescribed by the Commissioner, regarding a

licensee. The customer would have to include documentary or other evidence of the violation or activities of the licensee. The Commissioner would have to investigate the complaint.

The Commissioner could investigate or conduct examinations of a licensee and conduct hearings as he or she considered necessary to determine whether a licensee or any other person had violated the bill, or whether a licensee had conducted business in a manner that justified suspension or forfeiture of its authority to engage in the business of deferred presentment services.

The Commissioner could subpoena witnesses, documents, and other evidence in any matter over which he or she had jurisdiction, control, or supervision. If a person failed to comply with a subpoena issued by the Commissioner, or to testify with respect to any matter about which the person could be lawfully questioned, the Commissioner could petition the Circuit Court for Ingham County to issue an order requiring the person to attend, give testimony, or produce evidence.

Administrative Sanctions

Cease & Desist Order. The Commissioner could serve a notice of intention to issue a cease and desist order if, in the opinion of the Commissioner, a licensee were engaging in, had engaged in, or were about to engage in a practice that posed a threat of financial loss or threat to the public welfare, or were violating, had violated, or were about to violate the bill, State or Federal law, or an applicable rule or regulation. The notice would have to contain a statement of the facts constituting the alleged practice or violation and fix a time and place for a hearing, at which the Commissioner would determine whether to issue an order to cease and desist against the licensee.

A licensee who failed to appear at the hearing would consent to the issuance of the cease and desist order. If the licensee consented, or upon the record made at the hearing the Commissioner found that the practice or violation specified in the notice had been established, the Commissioner could serve upon the licensee an order to cease and desist from the practice or violation. The order could require the licensee and its executive officers, employees, and agents to cease and desist from the practice or violation, and to take affirmative action to correct conditions resulting from the practice or violation.

Except to the extent it was stayed, modified, terminated, or set aside by the Commissioner or a court, a cease and desist order would be effective on the date of service. An order issued with the licensee's consent would be effective at the time specified in the order and remain effective and enforceable as provided in it.

License Suspension or Revocation. After notice and hearing, the Commissioner could suspend or revoke any license if he or she found that the licensee had knowingly or through lack of due care done any of the following:

-- Failed to pay the annual license fee, or an examination fee imposed by the Commissioner.
-- Committed any fraud; engaged in any dishonest activities; or made any misrepresentations.
-- Violated the bill or any rule or order issued under it or violated any other law in the course of the licensee's dealings as a licensee.
-- Made a false statement in the license application or failed to give a true reply to a question in it.
-- Demonstrated incompetency or untrustworthiness to act as a licensee.
-- Engaged in a pattern or practice that posed a threat of financial loss or threat to the public welfare.

If the reason for revocation or suspension of a license at any one location were of general application to all locations operated by a licensee, the Commissioner could revoke or suspend all licenses issued to the licensee.

The Commissioner would have to comply with the Administrative Procedures Act (APA) concerning any notice or hearing under these provisions. A notice would have to contain a statement of the facts constituting the violation or pattern of practice and would have to fix a time and place at which the Commissioner would hold a hearing to determine whether an order to suspend or terminate one or more licenses of the licensee should be issued.

A licensee who failed to appear at a hearing would consent to the issuance of an order to suspend or terminate one or more licenses. If

a licensee consented, or upon the record made at the hearing the Commissioner found that the pattern of practice or violation specified in the notice had been established, the Commissioner could serve upon the licensee an order suspending or terminating one or more licenses.

Except to the extent it was stayed, modified, terminated, or set aside by the Commissioner or a court, an order suspending or terminating one or more licenses would be effective on the date of service. An order issued with the licensee's consent would be effective at the time specified in the order and remain effective and enforceable as provided in it.

Fines. If the Commissioner found that a person had violated the bill, State or Federal law, or an applicable rule or regulation, the Commissioner could order the person to pay a civil fine of between $1,000 and $10,000 for each violation. If the Commissioner found that a person had violated the bill and knew or reasonably should have known that he or she was in violation, the Commissioner could order the person to pay a civil fine of at least $5,000 but not more than $50,000 for each violation. The Commissioner also could order the person to pay the costs of the investigation.

In determining the amount of a fine, the Commissioner would have to consider the extent to which the violation was knowing and willful, the extent of the injury suffered because of it, the corrective action taken by the licensee to ensure that it would not be repeated, and the record of the licensee in the complying with the bill.

If a civil fine were assessed, it could be sued for and recovered by and in the name of the Commissioner, and could be collected and enforced by summary proceedings by the Attorney General.

Hearing. A licensee who was ordered to cease and desist or pay a fine, or whose license was suspended or terminated, would be entitled to a hearing before the Commissioner if a written request for a hearing were filed with the Commissioner within 30 days after the effective date of the order.

Any administrative proceedings under the bill would be subject to the APA.

Other Provisions

The Commissioner could issue orders and regulations that he or she considered necessary to enforce and implement the bill. The Commissioner would have to give a copy of any order or regulation issued to each license holder at least 30 days before it took effect.

To assure compliance with the bill, the Commissioner could annually examine the relevant business, books, and records of any licensee, at the licensee's expense. Each licensee would have to keep and use in its business any books, accounts, and records the Commissioner required. A licensee would have to preserve the documents for at least two years, unless applicable State or Federal law concerning record retention required a longer period.

The Commissioner could promulgate rules under the APA to enforce and administer the bill.

A person who provided deferred presentment services before July 1, 2004, would be considered to have complied with applicable State law if the person provided the services in substantial conformity with the rulings and interpretive statements then in effect that were issued by OFIS or its predecessor agency.

BACKGROUND

On April 25, 1995, the Financial Institutions Bureau (now within OFIS) issued a declaratory ruling that addressed whether a "payday advance transaction" was subject to the Regulatory Loan Act (In re: Request by Oak Brook/Cash Now Partners d/b/a/ Cash Connection for a Declaratory Ruling...). The business proposed to offer a service in which there would be an oral agreement to hold a present-dated check for up to 14 days. For a charge 10% to cash the check and an additional 5% to hold it for later presentment, the check would be exchanged for cash, and the issuer of the check would promise to have funds in his or her account on the agreed-upon date.

The Financial Institutions Bureau (FIB) determined, "...the substance of the transaction, notwithstanding its form, clearly indicates that a Payday Advance, as described, creates an obligation to repay the sum

advanced, and thus is a loan...as that term is used under the Regulatory Loan Act." (That Act requires a lender to be licensed if the interest on a loan exceeds the maximum annual rate permitted under the general usury law, i.e., 5% or, if the parties stipulate in writing, 7%.)

The FIB also concluded that the 5% fee for holding a check was interest, citing a 1985 opinion of the Michigan Supreme Court, "'Interest is compensation allowed by law or fixed by the respective parties for the use or forbearance of money, 'a charge for the loan or forbearance of money,' or a sum paid for the use of money, or for the delay in payment of money.' ***Town & Country Dodge v Mich. Dept. of Treasury***, 420 Mich. 226...". The FIB determined that, if annualized, "...the effective interest rate charged on the typical Payday Advance amounts to 153.3% per annum... As a result, it is clear that the Payday Advance, as described, falls within the class of loans intended to be regulated by the Legislature when it enacted the Regulatory Loan Act."

In 1998, the Financial Institutions Bureau was presented with another payday advance program under which "...the Company will cash a personal check for a customer for the normal charge and will also agree to defer the deposit and presentment of that check for up to 14 days for an additional fee at a rate not to exceed five percent per annum." In a letter to the company's legal counsel, the FIB Commissioner determined that the company did not need to obtain a license under the Regulatory Loan Act, and did not charge an interest rate in excess of the applicable rate ceiling (April 29, 1998).

On January 11, 2000, the FIB Commissioner replied to an inquiry from the Consumer Federation of America about Michigan law. The Commissioner stated, "In response to the [1995 declaratory] ruling, companies of which we are aware developed pricing strategies that brought the interest portion of the payday advance charge within the limits allowed under Michigan's Usury Act. By charging a rate of interest not in excess of the 7% usury cap, companies are not subject to the licensing requirements of the Regulatory Loan Act of 1963."

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The payday advance industry emerged to fill the void created when traditional lenders withdrew from the small loan market in the 1980s. Although bank cards may satisfy many consumers' small and short-term credit needs, other consumers still have limited access to this type of credit. Thus, payday advance businesses perform a valuable service for individuals who find themselves short of cash until they receive their next paycheck or other source of income. Payday advances, however, can cause financial hardship to consumers who secure advances frequently or renew them repeatedly. Because the fees charged are usually expressed in a dollar amount, many customers are unaware of the level of the fee in terms of a percentage rate. By using payday advances, customers might find themselves in perpetual debt when they cannot pay the face amount of their check and must renew their advance.

The proposed regulations would protect consumers in a number of ways. In particular, businesses would have to be licensed, customers could not have more than one outstanding payday advance at a time, and licensees could not charge a fee to renew a transaction. Customers would have to be informed of the terms of their transaction and of their rights, including the rights to cancel an agreement and to file a complaint against the licensee. In addition, licensees would have to post a bond and meet a net worth requirement.

These provisions would protect not only customers but licensees as well. Scrupulous payday advance services would have a license to show their legitimacy, and the reputation of the industry would improve. According to the NCSL, 32 states have enacted laws or adopted regulations that permit payday advances. Rather than simply allowing the industry to operate with no standards or oversight, Michigan should join the majority of other jurisdictions that regulate it.

Opposing Argument

The proposed 18% maximum fee would be exorbitant, if not usurious. When considered on an annual percentage basis, 18% on a two-week advance would equate to 446%. For a 31-day advance of $1,000, the customer would have to pay $180, which would amount to an annualized interest rate over 200%,

without compounding. In contrast, the State's general usury law allows an unregulated lender to charge only 7% under a written agreement (MCL 439.31). Charging more than 25% in simple interest per annum "or the equivalent rate for a longer or shorter period" is criminal usury, which carries a penalty of imprisonment for up to five years and/or a maximum fine of $10,000 (MCL 438.41). A licensee under the Regulatory Loan Act is limited to the rate allowed by the Credit Reform Act, which prohibits regulated lenders from charging any rate of interest or finance charge for an extension of credit that exceeds 25% per annum (MCL 445.1854). Furthermore, there is very little competition within the industry that otherwise might lead to lower charges. Although there may appear to be numerous payday advance services, many are owned by a single company.

Response: Since a deferred presentment transaction would be limited to 31 days and could be renewed only if no fee were charged, the annualized interest rate would not be relevant. Furthermore, the fee would not be the same as interest, because it would not be for the time-value of the money. Under the bill, the service fee that licensees could charge would be earned on the date of the transaction. The bill also states that the service fee "is not interest".

According to the NCSL, 15 states essentially prohibit payday lending through strict rate caps. If Michigan followed suit, consumers would find themselves without this source of temporary credit.

Opposing Argument

Instead of creating a new licensing program and treating payday advance businesses differently from other lenders, the State should simply enforce existing law. Regardless of what they are called, or whether their charge is called a "fee" or "interest", these entities are making loans and should be subject to the Regulatory Loan Act. Despite the terminology used in the bill, the reasoning of the 1995 declaratory ruling is relevant. The customer would have an obligation to repay the amount advanced plus an additional charge, and the service fee would be a sum paid for the use of money.

Furthermore, a new licensing program would put an additional burden on OFIS. Although the bill would permit OFIS to charge fees necessary to administer the new program, an appropriation would be needed to authorize the hiring of personnel who would carry it out. Otherwise, core functions from other areas would have to be eliminated.

Opposing Argument

The requirements for licensees would be weak in two respects. Bonds are designed to provide restitution to customers if a company fails to uphold the standards of the law. The $50,000 that the bill would require is a fairly low amount for this type of protection, according to OFIS. Also, a licensee would have 15 days to inform OFIS after it filed for bankruptcy or reorganization, after any governmental authority instituted revocation or suspension proceedings against the licensee, or after the licensee or any of its officers was indicted for or convicted of a felony. According to OFIS, a licensee should be required to provide notice before, or immediately upon, the occurrence, not 15 days after the fact. More timely notice and a higher bond would improve consumer protection.

Opposing Argument

The bill would legitimize an industry that takes advantage of vulnerable consumers, such as minorities, senior citizens, and low-income workers, who have higher levels of debt relative to their income. The Credit Research Center, within the McConough School of Business at Georgetown University, investigated consumers' demands for payday advances. According to its 2001 report, nearly three-fourths of payday advance customers had been turned down by a creditor or not given as much credit as they applied for in the previous five years, they were less likely than the adult population as a whole to have a bank or retail credit card, and over half of those having a card had not used it in the previous year because they would have exceeded their credit limit.

Response: The study cited above also found that most customers were generally aware of the cost of the credit, used advances infrequently or moderately, had advances outstanding less than a total of three months during the year, and viewed the continued use of payday advances as a choice, not a burden from which they could not escape. Furthermore, it is in the interest of payday lenders to check customers' credit and make advances only to those who can repay them. If people choose to use this service instead of bouncing checks or incurring late payment charges on credit cards, that should be their decision.

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bill would require these licensed businesses to pay a fee that would be sufficient to cover the administrative costs of regulating this industry, which would make the addition of this industry under the regulated category revenue neutral. The bill also would create civil fines that could be assessed for noncompliance, which would be deposited into the General Fund. Without knowing how many civil fines would be assessed and at what levels, it is difficult to determine the revenue that would be generated from this bill.

Fiscal Analyst: Maria Tyszkiewicz

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