

## INFORMATION

### **Introduction**

HB494 protects the rights of Montana borrowers by requiring basic standards of ethical and responsible lending in payday lending transactions. The current payday lending act allows excessive finance charges and predatory loan structures that prohibit borrowers from paying off the loans. These predatory loans deplete families of their income and assets, destroy many families' already precarious financial stability, and have been a contributing factor in evictions, bankruptcies, and even foreclosures.

The amendments requested in HB494 are based on model consumer protection legislation developed by AARP, the National Consumer Law Center, and the Center for Responsible Lending. The provisions requested in this bill will promote fair and responsible consumer lending.

### **Background**

The Montana Deferred Deposit Loan Act was passed in 1999, with strong support from the payday loan industry. Several key consumer protections were forced out of the bill, resulting in a law that did little more than legalize questionable lending practices that had been banned for years. Until the payday loan bill was passed, these lenders not supposed to exceed the state usury rate (15% per annum, or 6% above the prime rate, whichever is higher), although many did.

### **Numbers**

In 2003, Montana had 93 payday lenders who made 159,301 loans on post-dated checks. The number of payday lenders in Montana had risen to 114 (a 23% increase) as of the end of 2004.

### **Payday Loan Basics**

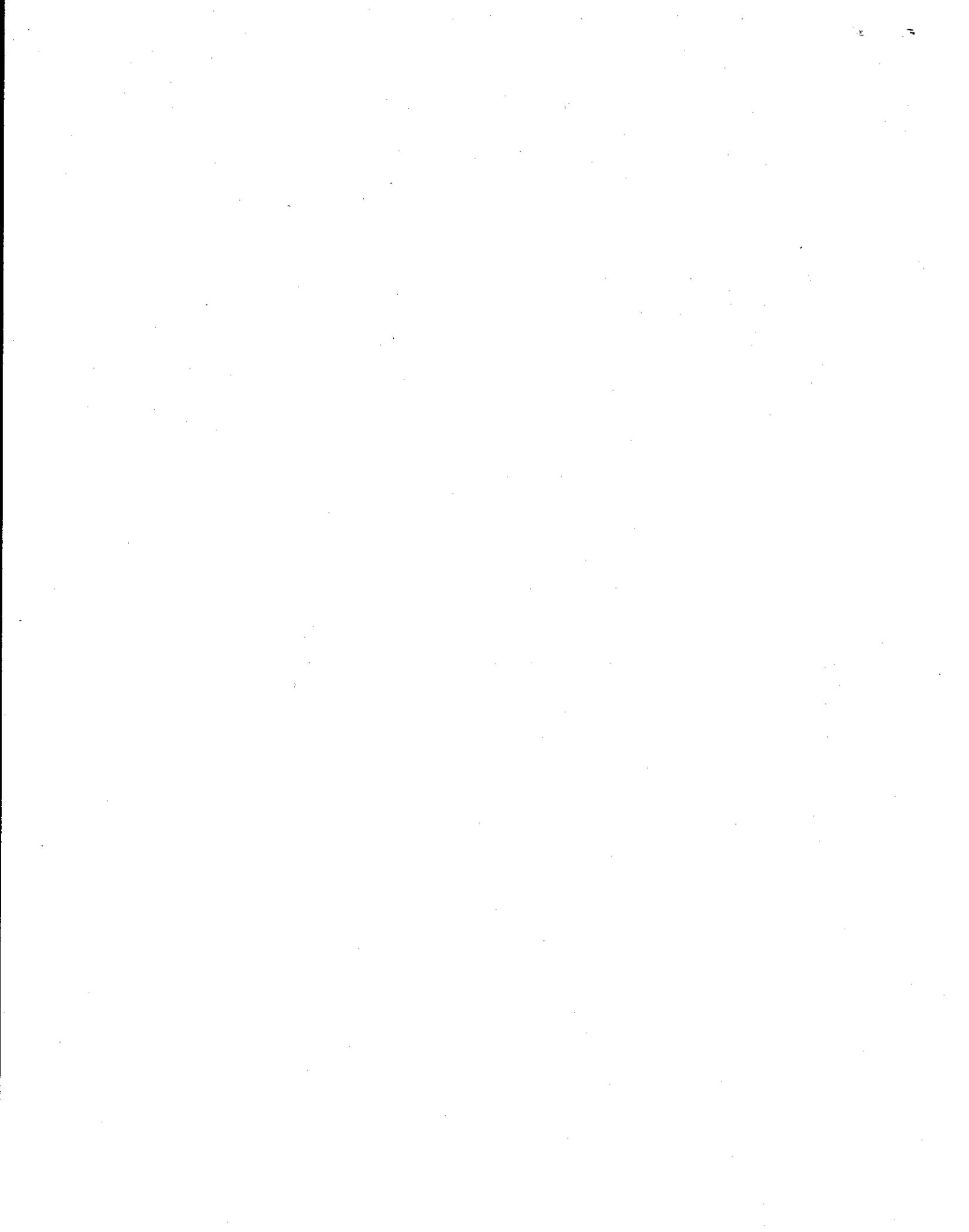
For a typical two-week payday loan of \$300, a borrower will pay a finance charge of up to \$75. This equals an **annual percentage rate (APR) of 652%**. If the borrower can't come up with \$300 at the end of two weeks to pay off the loan (which is usually pretty hard to do or they wouldn't be taking out a payday loan in the first place), they generally have no choice but to take out a second payday loan to pay off the first, and pay the \$75 finance charge again. Once they are trapped in this cycle, they will have to pay that same finance charge every two weeks - \$150 a month for a loan that was only for \$300. Or, they face having the check deposited against non-sufficient funds, which will result in NSF fees from the bank and the payday lender, as well as their checking account possibly being closed.

### **Payday Loans and Montana Families**

Montana households are losing family wealth to predatory payday loans. Many of these are families on the line between economic self-sufficiency and needing public assistance. Most are families with employment income who are living paycheck to paycheck.

With no underwriting guidelines, payday loans can easily consume a dangerous amount of a borrower's income. The financial emergency that prompted the borrower to obtain the loan is replaced by a very expensive debt that is simply due two to four weeks down the road. If the borrower can't pay the loan back in full, they risk being charged NSF fees, having their checking account closed, civil action, and wage garnishment for a judgment. Or they can pay another finance fee. Many borrowers become trapped in a cycle of being unable to pay off the loan in full when it is due (lenders do not have to accept partial payments). This is when the loans become problematic. Borrowers can't get out, and are stuck in on a treadmill of expensive finance fees.

Supporters of this bill include several social service agencies that provide consumer advocacy, housing counseling, emergency financial assistance, and assistance to low income families. While payday loans are used by both low and moderate income families, it is the lower income families who quickly become trapped and in need of help with utilities, food, transportation, childcare, and housing. A payday loan is not supposed to exceed 25% of the borrower's monthly income, but borrowers report this limit is often exceeded.



**WHY SUPPORT HB494?**

**“If we restrict the fees that payday lenders can collect, won't they go out of business?”**

- Our concern is for the economic health of Montana families and communities. Financially healthy families support local businesses and stabilize the local economy. Predatory lending simply undermines that stability and siphons wealth out of low and moderate income households.
- No one wants to hurt responsible Montana businesses. But profits are not justifiable at the expense of hardworking Montanans. In 2001, the payday loan industry reported a return on investment of 13.6%, which almost certainly understated actual profits.<sup>1</sup> Banks and credit unions average annual returns around 3%.
- Twenty states require payday lenders to comply with annual percentage rate caps of 36% or less. We feel an APR of 36% is fair; anything higher is taking advantage of desperate borrowers.
- No state in the country has adopted higher payday loan fees than Montana.

**“Customers *need* these loans. If fees are capped, payday lenders say they will be put out of business and people will have nowhere to turn in an emergency.”**

- Actually their customers find many places to turn to – including the social service agencies that can help them resolve their financial difficulties in a realistic way and achieve long term stability. They currently turn to these agencies *AFTER* they've paid hundreds of dollars in fees, found themselves unable to afford it any longer, their checking account has been closed, and they are being sued for damages. The damage done by predatory payday loans is a burden borne by entire communities.
- In addition, the Montana Credit Union Network and nine credit unions across the state are working to develop affordable community-based alternatives, based on successful national models. Once developed, the MCUN will provide the training and tools to enable every credit union across Montana to offer affordable payday loan alternatives in their communities. There is certainly a need for short-term emergency loans, and we feel it can be met responsibly and ethically, in a way that helps the borrower to regain financial stability, not destroy it.
- Remember, payday lending as we know it has only emerged in this decade. The practice has not exactly been an integral part of Montana's consumer lending history or families' traditional financial options.
- The last thing a family in a financial emergency needs is a loan with a 650% APR that has to be paid back in two weeks. That doesn't extend a helping hand; that cuts the life line. Families don't need predatory credit, they need real assistance. While payday loans might offer a short term solution for some, they offer a debt nightmare for many more.

**“Payday loan customers *WANT* these loans. Shouldn't they be allowed to make their own financial decisions?”**

- They will still be able to get a payday loan, but the transaction will be more fair and affordable.
- Policy decisions must be based on the health and wellbeing of Montana families and communities. There is a demand in Montana for many products that offer immediate gratification along with potential long-term harm to consumers, such as illegal substances. These products are regulated or prohibited for the good of the public, regardless of demand. Like drug addiction, predatory lending has negative effects for many borrowers, and is creating a growing burden on community services and public assistance programs that are paid for by all taxpayers.
- Again, just because customers *want* to use a payday loan, doesn't mean we must allow it to be offered on predatory terms.

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<sup>1</sup> 2001 Annual Reports to Montana Division of Banking and Financial Institutions. Return rates did not include salaries paid to owners, which were categorized as an expense.

**HB494 – Revising Payday Loan Act**  
Sponsor: Representative Eve Franklin

**“Sure, these loans are expensive, but they are short term loans and used only once or twice for an emergency, right?”**

- **Wrong. Ninety-one percent of all payday loans are made to repeat borrowers with five or more payday loans per year.**<sup>2</sup> Once the borrower is stuck in the loan, they have little control over how soon they pay it off. The average payday loan customer “rolls over” their loan ten times per year (paying off a loan that is due by taking out a new one)<sup>3</sup>. At a fee of \$75 every two weeks, the customer will pay \$750 and still owe the original \$300 borrowed.

**“The higher fees must be necessary for a reason – aren’t these borrowers a “higher risk?”**

- Only 1.6% of payday loans made by Montana lenders in 2001 were uncollectible due to default.
- The lender holds either a “live” check or electronic withdrawal agreement for a payday loan. The loan is secured – the lender has real collateral and the borrower has strong motivation to pay.
- If the borrower can’t pay the loan when it is due, the lender can collect either a finance fee for a new loan, or NSF fees, partial or full payment, a judgment, and attorneys fees.

**“Don’t we already have payday and title lending laws that work just fine? The industry says it is already regulating itself.”**

- Fine for whom? We don’t feel it’s “fine” for borrowers who are already desperate to pay APR of 600%, 800%, or more. It works fine for the lenders, but does little to protect borrowers.
- Industry “self-regulation” is generally a conflict of interest, with the consumer losing out. The industry’s objective is to make money, as with all industry. It is the job of the legislature, not the industry, to protect Montana consumers. It cannot be left to the payday loan industry to “self-police.”
- When the act was passed in 1999, the bill began as model consumer protection legislation, but several of the key consumer protection features of the model bill were stripped away under pressure from the payday lending industry. The act as passed was little more than an industry-backed charade of self-regulation.
- Montana is what the payday lending industry praises as an “enabling state”, meaning it’s a good place to open a predatory lending business because the industry has been able to favorably shape its own regulation.

**Bill Supporters and Members of Montana Alliance for Responsible Finance**

AARP – Statewide  
Beartooth Resource Conservation & Development – Joliet  
Billings Community Housing Resource Board (CHRB) - Billings  
Consumer Credit Counseling of Montana – Statewide  
Family Service, Inc. – Billings  
homeWORD – Billings, Missoula  
Montana Association of Churches  
Montana Homeownership Network – Statewide  
Montana Landlords Association – Statewide  
Montana Legal Services Association – Statewide  
Montana Women Vote – Statewide  
Native American Development Council – Billings  
Neighborhood Housing Services of Great Falls – Great Falls  
Office of the Attorney General, State of Montana  
North Central Montana Resource Conservation & Development – Shelby  
Women’s Opportunity and Resource Development, Inc. – Missoula  
Working for Equality and Economic Liberation – Helena  
YWCA’s of Montana – Statewide

<sup>2</sup> Keith Ernst, John Farris, and Uriah King, “Quantifying the Economic Cost of Payday Lending,” Center for Responsible Lending, 2003 ([www.responsiblelending.org](http://www.responsiblelending.org))

<sup>3</sup> Renuart, Elizabeth, “Payday Lending Myths and Realities.” Indiana Department of Financial Institutions, January 2001. ([www.dfi.state.in.us/ucc/PaydayMyths.html](http://www.dfi.state.in.us/ucc/PaydayMyths.html))

## Summary of Proposed Amendments to Deferred Deposit Lending Act and Title Loan Act

Deferred Deposit Lending Act (Payday Lending) – HB494	Title Loan Act – LC2033	More Information
Create an APR-based fee cap to prohibit finance charges from exceeding an annual percentage rate of 36%.	Create an APR-based fee cap to prohibit finance charges from exceeding an annual percentage rate of 36%.	This is the federal limit for credit cards and is the most common limit used in model legislation and many other states. It is very high compared to what a prudent consumer would accept as a decent credit card or bank loan rate. However, payday and title lenders currently charge <b>twenty or more times this rate.</b>
Require payday lenders to disclose potential loan costs using APR, and provide this information to the borrower in writing, in a conspicuous size and location, as part of the loan documents provided prior to entering the loan agreement.	Require title lenders to disclose potential loan costs using APR, and provide this information to the borrower in writing, in a conspicuous size and location, as part of the loan documents provided prior to entering the loan agreement.	This is consistent with the federal Truth In Lending Act (TILA), which requires lenders to disclose the costs of credit as an annual percentage rate, so that borrowers can compare credit options.
Revise loan term requirements to require <u>minimum</u> repayment term of fourteen days for every \$50 borrowed. Remove 31 day loan term maximum.	Revise loan term requirements to require <u>minimum</u> repayment term of thirty days for first \$500 borrowed, fourteen additional days for every additional \$100 borrowed.	Extremely short loan terms make it more likely the borrower will not be able to pay off the loan when it is due, and will be forced to take out a second loan or pay another finance charge. Realistic loan terms will assure that the borrower has a fair opportunity to repay the loan.
Require payday lenders to accept partial payments toward principal of at least \$5 at any time during the loan term.	Require title lenders to accept partial payments toward principal of at least \$5 at any time during the loan term.	Requiring lenders to allow partial payments will allow borrowers to pay down their loan, even if they are not able to pay it in full. Currently, lenders can refuse any payment less than the full amount owed.
Remove intent as a requirement for civil liability where lender has violated regulations.	Remove intent as a requirement for civil liability where lender has violated regulations.	Proving a lender "intentionally" committed a violation places an unfair burden on borrowers. Lenders can take many measures to ensure that they do not unknowingly violate a borrower's rights.
	Prohibit a title lender from giving more than one loan per vehicle.	This provision intends to prevent title lenders from circumventing minimum loan term requirements by giving borrowers multiple smaller loans.
	Clarify "pawnbroker exemption" to specify that pawnbrokers giving title loans must be licensed as title lenders and comply with the Title Loan Act.	Currently, some title lenders are calling themselves pawnbrokers or "title pawns" and using this loophole to exempt themselves from title loan regulation, even though they are giving title loans.

