

OVERVIEW

Sunrise Analysis: Check Cashing and Deferred Deposit Agreements (Payday Loans)

Report No. 05-11, December 2005

Summary

In House Concurrent Resolution No. 172, House Draft 1, the 2005 Legislature requested that the Auditor conduct a "sunrise" analysis of Senate Bill No. 1413 of the 2005 Regular Session which proposed to expand regulation of deferred deposit agreements or payday loans. The Hawai'i Regulatory Reform Act (Chapter 26H, Hawai'i Revised Statutes) requires such an analysis to ensure that new regulation is enacted only when necessary to protect the health, safety, and welfare of the public.

Payday loans are small, short-term, unsecured loans that borrowers promise to repay from their next paycheck or regular income payment such as a social security check. The borrower receives immediate cash in exchange for a check postdated to the next payday. Hawai'i law permits payday lenders to charge a fee of 15 percent of the face value of the check for each transaction and lend up to \$600. For example, a borrower would write a postdated check for \$117.65 to the payday lender in exchange for \$100 cash. On an annualized basis, this translates to 459 percent for a 14-day loan. Typically, borrowers need provide only a recent pay stub, a driver's license, a checkbook or bank statements, and a telephone bill to verify their address. About two dozen payday lenders currently operate in Hawai'i.

Currently, 37 states and the District of Columbia have enabling legislation for payday lenders to operate. The remaining states either prohibit payday lending or regulate payday lending under the state's usury laws. Most states require payday lenders to be licensed with requirements ranging from simple registration to such prelicensure requirements as bonding and criminal checks and such post-licensure requirements as periodic reports on business operations. Fees or interest rates that states allow range from 10 percent to no limit.

Senate Bill No. 1413 proposed to amend Chapter 480F on check cashing to require payday lenders to maintain records that would enable the director of the Department of Commerce and Consumer Affairs to determine if they are in compliance with the law. Lenders would have to file annual reports disclosing such information as their assets, liabilities, income, expenses, and the number of transactions. The bill requires the director to compile annual reports on the information received. The bill would limit fees to 36 percent per annum and reduce the maximum allowable loan amount from \$600 to \$300. The bill would also add prohibited acts and increase penalties for violations.

Proponents of regulation say that payday lenders charge exorbitant interest rates and lead borrowers into a debt trap from which they cannot escape. Payday lenders say that they are fulfilling a need and that the proposed legislation would eliminate a source of short-term credit that would force consumers into bouncing checks and



would make any future credit more expensive. They say that the 36 percent cap would put them out of business. Borrowers would then resort to less favorable alternatives such as Internet payday loans or fee based overdraft protection programs that charge even higher fees.

We found few complaints in Hawai'i and little evidence of harm—the primary criterion of the Regulatory Reform Act. However, national studies show that consumers typically take out several loans a year, often becoming chronic borrowers. A number of studies also report that payday lenders prey on the military. Because of this potential for harm, Chapter 480F should be amended but not as proposed by Senate Bill No. 1413. The senate bill would be too restrictive and would likely put payday lenders out of business. Instead, the amendments should strengthen the law to make it more consumer friendly.

Recommendations and Response

We recommend that Chapter 480F, HRS, be strengthened through the following amendments:

- Requiring payday lenders to post in a conspicuous place any and all fees that they charge for payday loans including the annual percentage rate for the loan,
- Reducing the maximum fee for a loan, and
- Instituting a mandatory registration program for all payday lenders with the Department of Commerce and Consumer Affairs.

The Department of Commerce and Consumer Affairs responded that it would not be able to generate a comprehensive list of payday lenders under a mandatory registration program since it does not require business entities to disclose the nature of their business. The department also commented that it does not require businesses to report ownership information. Nevertheless, we believe that the services offered by the department's Business Registration Division would benefit the public.

The department's Business Registration Division maintains a public registry of over 90,000 active business entities with essential basic information, which usually includes the names of the principals, officers or directors or partners, the address of the registrant and the date of filing of the registration. It issues "Certificates of Good Standing" to businesses that are registered and it responds to public requests for information and provides. In addition, it provides for the compliance review of business applications to assure the meeting of statutory requirements in each registration or application.

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