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

A Report to the Governor and the Legislature of the State of Hawai`i

Report No. 05-11
December 2005

THE AUDITOR
STATE OF HAWAI`I

Office of the Auditor

The missions of the Office of the Auditor are assigned by the Hawai`i State Constitution (Article VII, Section 10). The primary mission is to conduct post audits of the transactions, accounts, programs, and performance of public agencies. A supplemental mission is to conduct such other investigations and prepare such additional reports as may be directed by the Legislature.

Under its assigned missions, the office conducts the following types of examinations:

1. *Financial audits* attest to the fairness of the financial statements of agencies. They examine the adequacy of the financial records and accounting and internal controls, and they determine the legality and propriety of expenditures.

2. *Management audits*, which are also referred to as *performance audits*, examine the effectiveness of programs or the efficiency of agencies or both. These audits are also called *program audits*, when they focus on whether programs are attaining the objectives and results expected of them, and *operations audits*, when they examine how well agencies are organized and managed and how efficiently they acquire and utilize resources.

3. *Sunset evaluations* evaluate new professional and occupational licensing programs to determine whether the programs should be terminated, continued, or modified. These evaluations are conducted in accordance with criteria established by statute.

4. *Sunrise analyses* are similar to sunset evaluations, but they apply to proposed rather than existing regulatory programs. Before a new professional and occupational licensing program can be enacted, the statutes require that the measure be analyzed by the Office of the Auditor as to its probable effects.

5. *Health insurance analyses* examine bills that propose to mandate certain health insurance benefits. Such bills cannot be enacted unless they are referred to the Office of the Auditor for an assessment of the social and financial impact of the proposed measure.

6. *Analyses of proposed special funds* and existing *trust and revolving funds* determine if proposals to establish these funds are existing funds meet legislative criteria.

7. *Procurement compliance audits* and other *procurement-related monitoring* assist the Legislature in overseeing government procurement practices.

8. *Fiscal accountability reports* analyze expenditures by the state Department of Education in various areas.

9. *Special studies* respond to requests from both houses of the Legislature. The studies usually address specific problems for which the Legislature is seeking solutions.

Hawai`i's laws provide the Auditor with broad powers to examine all books, records, files, papers, and documents and all financial affairs of every agency. The Auditor also has the authority to summon persons to produce records and to question persons under oath. However, the Office of the Auditor exercises no control function, and its authority is limited to reviewing, evaluating, and reporting on its findings and recommendations to the Legislature and the Governor.

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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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Conducted by

The Auditor
State of Hawai`i
and
CRL Consulting, Inc.

Submitted by

THE AUDITOR
STATE OF HAWAI`I

Report No. 05-11
December 2005

Foreword

This "sunrise" report on deferred deposit agreements or payday loans was prepared in response to a provision in the Hawai`i Regulatory Licensing Reform Act, Chapter 26H, Hawai`i Revised Statutes, that requires the Auditor to evaluate proposals to regulate previously unregulated professions or vocations.

In House Concurrent Resolution No. 172, House Draft 1 of the 2005 legislative session, the Legislature requested an analysis of Senate Bill No. 1413 of the 2005 legislative session. The bill proposed to expand regulation of payday loans under Chapter 480F which regulates check cashing. This evaluation, conducted by CRL Consulting, Inc., presents our findings and recommendation on whether the proposed regulation complies with policies in the licensing reform law and whether a reasonable need exists to regulate payday loans to protect the health, safety, or welfare of the public.

We wish to express our appreciation to the Department of Commerce and Consumer Affairs and other organizations and individuals that we contacted during the course of the evaluation.

Marion M. Higa
State Auditor

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Chapter 1

Introduction

This report responds to a "sunrise" provision in the Hawai`i Regulatory Licensing Reform Act—Chapter 26H, Hawai`i Revised Statutes (HRS). The sunrise provision requires that, prior to enactment, bills proposing regulation of previously unregulated professions or vocations be referred to the Auditor for analysis. The Auditor is to assess whether the proposed regulation is necessary to protect the health, safety, or welfare of consumers and whether it is consistent with other regulatory policies in Chapter 26H. In addition, the Auditor is to examine the probable effects of the proposed regulation and assess alternative forms of regulation.

Senate Bill No. 1413 of the 2005 legislative session proposed to expand regulation of deferred deposit agreements, commonly known as payday loans, under Chapter 480F, HRS, which regulates check cashing. The Legislature specifically requested an analysis of S.B. No. 1413 in House Concurrent Resolution No. 172, House Draft 1, of the 2005 legislative session. Deferred deposit agreements or payday loans are high interest, short-term loans backed by postdated personal checks. These loans are also known as deferred presentments, payday advances, or deferred deposit loans.

Background

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. Borrowers are primarily low- to moderate-income working families, often with poor credit records, who find themselves in need of emergency cash. The payday lender will give a customer immediate cash in exchange for a check postdated to the next payday or income payment. For example, to receive $100 in cash, the customer writes a check for $117.65 to the payday lender, dated for the next payday. The additional $17.65 represents a 15 percent fee on the face value of the check. Loan periods are usually 14 days or until the next payday. Those who are paid once a month have a loan period of a month or until the next payday. The same fee is charged whether the loan period is less than 14 days or up to 31 days. Typically, the payday lender requires the borrower to provide only recent pay stubs or evidence of a regular source of income, a driver's license, a checkbook or bank statements to demonstrate that the borrower has a bank account, and a telephone bill to verify the borrower's address.

On the due date of the loan, the customer is required to pay off the face amount of the check in full ($117.65 in the above example). The payday lender then returns the customer's personal check. Customers who cannot pay off the loan may be given an opportunity to extend the term of the loan, pay in installments, or take out another payday loan to pay off the first loan. Payday lenders follow customary collection practices when customers do not repay the loan on or before the due date. They may call and send letters to the borrower, use a collection agency, deposit the customer's personal check, or resort to small claims courts. If a lender obtains a judgment from a small claims court, the lender can garnishee a customer's wages. The payday lender may also charge a fee for a returned check. In some cases, the payday lender simply writes off the loan.

The payday lending industry

The payday lending industry has grown dramatically in recent years. The Center for Responsible Lending, a nonprofit research and policy organization aimed at ending abusive financial practices, reports that the payday lending industry quadrupled in size between 2000 and 2003. At the end of 2003, approximately 22,000 outlets were generating $6 billion in fees from about 100 million transactions nationally.[1]

The Community Financial Services Association of America (CFSA), the association for the payday industry, estimates that payday advance locations nationwide currently extend about $25 billion in short-term advances to borrowers.[2] The CFSA says that payday advances grew because of robust consumer demand and changing conditions in the financial services marketplace. These conditions include:

- Traditional financial institutions leaving the small-denomination, short-term credit market because of the high cost of these types of loans.

- The soaring cost of fees for bounced checks, late payment penalties, and other short-term credit products that had negative credit consequences for some consumers.

- Enactment of enabling legislation that provided regulations and consumer protections for payday advance customers.[3]

The industry is still fragmented but has been consolidating. Seven of the largest payday lenders are now publicly traded. Together, these seven corporations have 7,127 stores generating $2.5 billion in gross revenues.[4] Advance America, the largest publicly traded payday lender, has twice as many stores as the next largest provider of payday cash advance services. It focuses exclusively on payday cash advance services. As of December 31, 2004, it operated 2,408 payday cash advance centers in 34 states with total revenues of $481 million.[5] Between 2003 and the end of 2004, Advance America added 799 payday centers in 30 states (it currently does not operate in Hawai'i).

Advance America says it has grown by identifying attractive locations for new payday cash advance centers. It uses its database of approximately 3.4 million customer records to analyze market opportunities and make management decisions on expanding its network of payday cash advance centers.[6] The company believes that the loans offer customers a simple, quick, and confidential solution to meet short-term cash needs while avoiding the potentially higher costs and negative credit consequences of other alternatives.

Advance America was a founding member of CFSA. Through CFSA, it has encouraged favorable state legislation that would permit lenders to operate profitably. Between 2003 and 2004, Advance America and CFSA supported legislation that has been adopted in 26 states. It reported that the number of jurisdictions with specific legislation and/or regulations permitting payday cash advances or small loans has grown from 16 states in 1997, the year in which Advance America began its operations, to 37 states and the District of Columbia as of December 31, 2004.[7]

Customer profile

A report by Sheila Bair, professor of financial regulatory policy at the Isenberg School of Management, University of Massachusetts at Amherst, reported that industry surveys show the following profile for payday loan customers:

- All are bank or credit union customers since a bank account is a prerequisite for a payday loan; most are low to middle income workers with 52 percent making between $25,000 to $50,000;

- Forty-one percent own their own homes as compared to a 60 percent national average; and

- African-Americans and military families are an important customer base.[8]

This profile agrees with the characteristics reported by Advance America. In addition to the above, Advance America says that 84 percent of its customers have a high school degree compared with a national average of 80 percent.[9]

A review of key operating data from Advance America is useful since the company focuses solely on payday loans. It reported that it had made 11,586,000 loans to 1,412,000 customers in the year ended 2004. This means that the average customer took out about eight loans a year. The average loan amount was $328 with an average duration of 14 days. The average charge to customers for a payday cash advance was $52.[10]

Payday business models

Payday lenders use what they call a "standard business model" in those states having a favorable regulatory environment. In this model, lenders make cash advances directly to customers and fund the advances themselves. In states that prohibit payday lending or are without legislation authorizing payday lending, they use a "charter-renting" model in which they act as agents for state-chartered banks.

Federal interstate banking laws and guidelines allow a Federal Deposit Insurance Corporation (FDIC)-insured, state-chartered bank located in one state to make loans to a consumer in another state. This allows a state-chartered bank to "export" or to charge the fees and/or interest allowed by its home state even if the fees and/or interest exceed what may be charged in the consumer's state. Under the state charter-renting model, payday lenders act as processing, marketing, and servicing agents. The lending banks fund the advances and determine the terms, conditions, and features of the cash advance. All the repayments are deposited in the state-chartered bank and the bank pays processing, marketing, and service fees to the payday lender.

Regulation in the 50 states

Currently, 37 states and the District of Columbia have enabling legislation that allows payday lenders to operate. The remaining states either prohibit payday lending or, in the absence of regulation, regulate loans under the state's usury laws. Individual states regulate various dimensions of payday lending such as maximum fees, loan amounts, a limit on the number of renewals or rollovers permitted, and mandatory cooling-off periods between transactions. In addition, some states require certain disclosures and restrict advertising content. Exhibit 1.1 shows the states and some of their regulatory provisions including whether they require payday lenders to have a license, the maximum allowable loan amount, the fees charged, and the resulting annual percentage rate (APR).

As seen in Exhibit 1.1, most states require payday lenders to be licensed. Licensing requirements range from simple registration to prelicensure requirements such as bonding, character references, criminal checks, and post-licensure requirements such as periodic reports on business operations.

States vary in the maximum amount of loans allowed and maximum fees charged for the loan. The maximum loan amounts among the states range from $50 to $1,000. The permitted fees and/or interest on a cash

Exhibit 1.1
State Regulations on Payday Lending

	License*	Cost per $100	Eff. APR % 14 days	Maximum Loan
Alabama	Yes	$17.50	455%	$500
Alaska	Yes	$20.00	520%	$500
Arizona	Yes	$17.65	459%	$500
Arkansas	Yes	$22.22	579%	$400
California	Yes	$17.65	459%	$300
Colorado	Yes	$20.00	520%	$500
Delaware	No	no limit	no limit	$500
District of Columbia	Yes	$16.10	419%	$1,000
Florida	Yes	$15.00	390%	$500
Hawai‘i	No	$17.65	459%	$600
Idaho	Yes	no limit	no limit	25% of income
Illinois	Yes	no limit	no limit	$400
Indiana	No	$15.00	390%	$500
Iowa	Yes	$16.67	435%	$500
Kansas	No	$15.00	390%	$500
Kentucky	Yes	$17.65	459%	$500
Louisiana	Yes	$20.00	520%	$350
Minnesota	Yes	$15.00	390%	$350
Mississippi	Yes	$22.00	572%	$400
Missouri	Yes	$75.00	1980%	$500
Montana	Yes	$25.00	650%	$300
Nebraska	Yes	$17.65	459%	$500
Nevada	Yes	no limit	no limit	25% of income
New Hampshire	Yes	no limit	no limit	$500
New Mexico	Yes	no limit	no limit	no limit
North Dakota	Yes	$20.00	520%	$500
Ohio	Yes	$15.00	390%	$500
Oklahoma	Yes	$15.00	390%	$500
Rhode Island	Yes	$10.00	260%	$300
Oregon	Yes	no limit	no limit	no limit
South Carolina	Yes	$17.65	459%	$300
South Dakota	Yes	no limit	no limit	$500
Tennessee	Yes	$17.65	459%	500
Texas	Yes	$11.87	309%	$350
Utah	Yes	no limit	no limit	no limit
Virginia	Yes	$15.00	390%	$500
Washington	Yes	$15.00	390%	$700
Wyoming	Yes	$30.00	780%	None

* Individal state codes

Per National Conference of State Legislatures, “Payday Lending,” May 6, 2005. Connecticut, Delaware, Illinois, Maine, Massachusetts, Michigan, New Jersey, New York, N. Carolina, Oregon, Pennsylvania, Texas, Vermont, W. Virginia do not cap interest rates or have specific regulation.

Source: Jean Ann Fox and Anna Petrini, Internet Payday Lending, Consumer Federation of America, Washington, D. C., November 2004.

advance vary from 10 percent to no specified limit on the amount of the loan. Payday lenders may also charge additional processing fees, late fees, and/or fees for returned checks.

Federal regulation

Payday lenders are also subject to federal regulation. Such regulations include:

- Regulation Z of the Federal Truth in Lending Act that requires detailed disclosure of the price and terms of a payday loan, including the APR and finance charges;
- Guidelines issued by the FDIC relating to state chartered banks that engage in agency relationships with payday lenders (see explanation of guidelines below);
- The Equal Credit Opportunity Act that prohibits discrimination in lending based on sex, marital status, age, race, national origin, or because the borrower receives public assistance income;
- The Gramm-Leach-Billey Act that provides for safeguards relating to customer privacy and record safekeeping; and
- The Fair Debt Collection Practices Act that provides for certain kinds of protection from creditors and collectors who use unfair, unethical and illegal collection tactics.

In March 2005, the FDIC issued new guidelines for state banks that engage in charter-renting relationships with payday lenders. These guidelines seek to limit rollovers by specifying the number and frequency of extensions, deferrals, renewals, and rewrites. They prohibit additional advances to finance unpaid interest and fees and simultaneous loans to the same customer. The guidelines also establish waiting periods between the time a payday loan is repaid and another application is made, specify the maximum number of loans per customer allowed in a year, and provide that no more than one payday loan be outstanding with the bank at a time to any one customer. FDIC-supervised institutions currently engaged in payday lending are required to submit plans to the FDIC detailing how they will address the revised guidance.[11]

Payday lenders in Hawai‘i

About two dozen payday-lending businesses operate in Hawai‘i. An exact number is difficult to determine since they are not required to register with any state agency. Some list their services under check cashing or loans in the telephone yellow pages; others advertise online or can be found in Polk’s City Directory. Some pawnbrokers also engage in payday lending. Exhibit 1.2 lists the payday businesses that we located from the above sources. We also determined the ownership of the businesses and the number of stores that they operated from the commerce department's Business Registration Division and an informal survey we conducted of the businesses.[12] Most of the payday lenders are independent, locally owned businesses. Others are operated by mainland interests or are franchises.

Hawai'i businesses vary in size, ranging from privately owned single stores to businesses like Payday Hawaii, a Hawai'i corporation with seven retail outlets on the Neighbor Islands and plans to open three more outlets on O'ahu.[13] Others, like Money Mart, with three local retail outlets, are owned by the Dollar Financial Group, a publicly traded corporation that operates internationally with more than 1,000 locations in the United States, Canada and the United Kingdom.

Current regulation in Hawai'i

Payday lending is regulated under Chapter 480F, HRS, Check Cashing, which regulates both check cashing and deferred deposits. It defines deferred deposits as agreements where a check casher refrains from depositing a personal check from a customer until a specified date after the transaction date. The regulation was enacted in 1999 because of concerns over potential abuses due to excessive fees, rollover of debts, and mandatory collateral purchases. The bill had the support of the American Association of Retired Persons. It also had the support of the payday lending industry because it would specifically exempt payday lending businesses from the State's usury law. An early version of the bill required check cashers to be registered with the Department of Commerce and Consumer Affairs, but the registration requirement was removed because of resource limitations at the department. The original legislation also had a sunset date of 2001 that the Legislature removed in 2001.

The statute focuses on the business practices of those who provide payday loans. The law requires each deferred deposit, or payday loan, to have a written agreement signed by both the payday lender and the customer. The agreement must include a statement of the total fees charged for the deferred deposit, expressed both as currency and as an annual percentage rate. The payday lender may not:

- Lend more than $600;

- Defer repayment for more than 32 days;

- Exceed a fee of more than 15 percent of the face amount of the check; and

Exhibit 1.2
Payday Lenders in Hawai‘i

Name	Location	# of Stores	Ownership
Ace America Cash Express	O‘ahu	1	Franchise
Advance Til Payday	O‘ahu	5	Hawai‘i LLC
Bela Enterprises	O‘ahu	1	Hawai‘i sole prop.
Bluewater Check Cashing	O‘ahu	1	Hawai‘i LLC
Cash in Advance	O‘ahu	4	Hawai‘i corp.
Check to go	O‘ahu	1	Hawai‘i LLC
Colortyme	O‘ahu	3	Franchise
Easy Money	O‘ahu/Maui	4	Mainland corp.
Everyday's Payday	O‘ahu	1	Hawai‘i partnership
Family Pawn and Payday Loans	O‘ahu	2	No info. available
Hawaii Check Cashing	O‘ahu	2	Hawai‘i corp.
Island Cash	O‘ahu	1	No info. available
Jewel Masters	O‘ahu	1	No info. available
Kamaaina Loan	Maui	1	Hawai‘i. corp.
Kanaka Kash, Inc	Kaua‘i	1	Hawai‘i corp.
Kaneohe Pawn	O‘ahu	1	Hawai‘i corp.
Kihei Kash	Maui	1	Hawai‘i LLC
Liliha Pawn	O‘ahu	1	No info. available
Money Mart/Cash til Payday	O‘ahu	3	Mainland corp.
Mr. Cash	O‘ahu	1	Hawai‘i corp.
North Star Pawn	O‘ahu	1	Hawai‘i corp.
Pacific Check Cashing	O‘ahu	1	Hawai‘i LLC
Payday Loans	Hawai‘i/Maui	3	Hawai‘i corp.
Payday Hawaii	Hawai‘i, Maui, O‘ahu, Kaua‘i	7	Hawai‘i corp.

Source: Department of Commerce and Consumer Affairs, Business Registration Division; www.htyellow pages.com; Polks City Directory 2004; consultant's surveys.

- Enter into another agreement when an earlier agreement is in effect or allow the earlier agreement to be repaid, refinanced, or consolidated with the proceeds from another deferred deposit transaction.

Those who violate these provisions are subject to a fine of $500 and up to 30 days imprisonment. Any injured consumer may sue for damages under Section 480-13(b), HRS, the state law prohibiting unfair competition and unfair and deceptive practices. Judgments for the consumer could result in awards of not less than $1,000 or threefold damages and reasonable attorney fees together with the costs of suit.

Currently, no division at the Department of Commerce and Consumer Affairs is responsible for administering or interpreting the law. Consumer complaints relating to check cashers are referred to the department's Office of Consumer Protection for follow-up. The Office of Consumer Protection investigates alleged violations of consumer protection laws and takes legal action to stop unfair or deceptive practices.

Proposed regulation

Senate Bill No. 1413 of the 2005 legislative session seeks to expand regulation of payday lending by amending Chapter 480F, HRS, relating to check cashing. It would add a number of requirements related to their business practices. It would require check cashers who provide payday lending services to maintain books, accounts, and records that would enable the director of the commerce department to determine compliance with the law. Lenders would also have to file annual reports disclosing resources, assets, liabilities, income, expense, balance sheets, the total number of deferred deposits made, the average APRs, total number of returned checks and other information. The proposed bill would also require the commerce director to compile annual reports on the information received.

The bill would clarify the disclosure requirements and require that the fees and the APR be posted in a conspicuous place. In addition, the bill would limit any fees and interest charged to 36 percent per annum and reduces the maximum allowable loan amount from $600 to $300.

The bill would add a number of prohibited acts. It would prohibit lenders from including in an agreement such provisions as mandatory arbitration and waiver of the right to a jury trial. Lenders would be required to give customers an informational pamphlet relating to charges, the customer's rights and responsibilities, and so on. The bill would also increase penalties for violations from $500 to $1,000 and imprisonment terms from 30 days to six months.

Proponents of the bill were primarily nonprofit consumer organizations that are involved in credit counseling and in helping families gain economic self-sufficiency. Among these was the Hawai‘i Alliance for Community-Based Economic Development and the Hawaii Asset Building Coalition. Aloha United Way and the Legal Aid Society of Hawai‘i also testified in support of the bill. Their concern was directed at the exorbitant interest rates charged to those who could least afford them.

The Community Financial Services Association of America testified against the bill, saying it was anti-industry and anti-consumer. It said that the bill would eliminate a popular source of short-term credit and force consumers into bouncing checks and paying late fees, which would make any future credit more expensive. The association maintained that the bill would also drive consumers to Internet payday lending with its even higher fees.

Objectives

1. Determine whether there is a reasonable need to regulate payday lenders to protect the health, safety, or welfare of the public.

2. Assess the probable effects of regulation, specifically the effects on payday lenders.

3. Make recommendations, as appropriate, based on our findings.

Scope and Methodology

To assess the need to regulate payday lenders as proposed in S.B. No. 1413, we applied the criteria set forth in Section 26H-2, HRS, of the Hawai‘i Regulatory Licensing Reform Act. The Legislature established these policies to ensure that regulation of an occupation occurs only when needed to protect consumers. Regulation is an exercise of the State’s police power and should not be imposed lightly. Its primary purpose is not to benefit practitioners of the occupation who often seek regulation for reasons that go beyond consumer protection. For example, some practitioners believe that licensing will enhance the professional status of their occupation.

The consumer protection purpose of regulation is clearly articulated in the policies set forth in Section 26H-2, HRS, amended by Act 45 of 1996. They say that:

- The State should regulate professions and vocations only where reasonably necessary to protect consumers;

- Regulation should protect the health, safety, and welfare of consumers and not the profession;
- Evidence of abuses should be given great weight in determining whether a reasonable need for regulation exists;
- Regulation should be avoided if it artificially increases the costs of goods and services to the consumer, unless the cost is exceeded by potential dangers to the consumer;
- Regulation should be eliminated when it has no further benefit to consumers;
- Regulation should not unreasonably restrict qualified persons from entering the profession; and
- Aggregate fees for regulation and licensure must not be less than the full costs of administering the program.

The national Council on Licensure, Enforcement and Regulation also offers guidance on the regulation of occupations. In its publication *Questions a Legislator Should Ask,*[14] the Council says that the primary guiding principle for legislators is whether the unregulated profession presents a clear and present danger to the public's health, safety, and welfare. If the answer is no, regulation is unnecessary and wastes taxpayers' money.

We also used additional criteria for this analysis, including whether:

- The incidence or severity of harm based on documented evidence is sufficiently real or serious to warrant regulation;
- No alternatives provide sufficient protection to consumers (such as federal programs, other state laws, marketplace constraints, private action, or supervision); and
- Most other states regulate the occupation for the same reasons.

In assessing the need for regulation and the specific regulatory proposal, we placed the burden of proof on proponents of the measure to demonstrate the need for regulation. We evaluated their arguments and data against the above criteria. We examined the regulatory proposal and assessed whether the proponents provided sufficient evidence for regulation. In accordance with sunrise criteria, even if regulation *may* have *some* benefits, we recommend regulation only if it is *demonstrably* necessary to protect the public.

We scrutinized the appropriateness and the regulatory approach taken by the proposed legislation. Three approaches are commonly taken to occupational regulation:

- *Licensing,* the most restrictive form, confers the legal right to practice to those who meet certain qualifications. Penalties may be imposed on those who practice without a license. Licensing laws usually authorize a board that includes members of the profession to establish qualifying requirements and implement rules and standards of practice.

- *Certification* restricts the use of certain titles (for example, social worker) to persons who meet certain qualifications, but it does not bar others who offer such services without using the title. Certification is sometimes called *title protection*. Government certification should be distinguished from professional certification, or credentialing, by private organizations. For example, social workers may gain professional certification from the National Association of Social Workers.

- *Registration* is used when the threat to the public health, safety, or welfare is relatively small or when it is necessary to determine the impact of the operation of an occupation on the public. A registration law simply involves having practitioners enroll with the State so that a roster or registry is created and the State can keep track of practitioners. Registration may be mandatory or voluntary.

In addition to assessing the need for regulation and the specific legislative proposal, we considered the appropriateness of other regulatory alternatives. We also assessed the cost impact on the proposed regulatory agency and the regulated group.

In conducting the analysis, we researched the literature on payday lending. We also reviewed trends and regulation nationally and in other states. We interviewed payday lenders and consumer advocates for the bill. We reviewed complaints filed at the commerce department's Office of Consumer Protection and its Regulated Industries Complaints Office. We surveyed payday lenders operating in Hawai'i and visited several payday-lending offices. We conducted our assessment from July 2005 to September 2005.

Chapter 2

Regulation of Payday Lenders Should Be Strengthened

This chapter presents our findings and recommendations on the proposal to regulate deferred deposit check cashers, or payday lenders, as proposed in Senate Bill No. 1413, 2005 Regular Session. Senate Bill No. 1413 proposes to amend Chapter 480F, HRS, to expand the regulation of business practices of check cashers who engage in payday lending. The proposed regulation would likely drive local payday lenders out of business and subject borrowers to less favorable alternatives. Although we found little evidence of harm to consumers, the potential for harm exists. Thus, it would be useful to expand certain regulatory provisions by amending Chapter 480F, HRS, to require payday lenders to register, to clarify certain provisions relating to payday loans, and to lower the maximum fee that may be charged for a payday loan.

Summary of Findings

Senate Bill No. 1413 of the 2005 Regular Session should not be adopted, but regulation of payday lenders can be strengthened by amending Chapter 480F, HRS.

Little Evidence of Harm

The Hawai‘i Regulatory Reform Act clearly states that regulation should be undertaken only when necessary to protect the health, safety, and welfare of consumers. Consumer groups that supported increased regulation contend that consumers need to be protected since payday lenders do not adequately inform them about the true costs of borrowing, that lenders engage in unfair and deceptive practices, and that they encourage repeated loan rollovers that result in chronic borrowing. Supporters say that those who borrow from payday lenders may fall into a cycle of debt from which they cannot escape. They say that the exorbitant interest rates that payday lenders charge the working poor eat up a considerable portion of their pay and contribute to unmanageable levels of personal indebtedness. Proponents of increased regulation also say that payday lenders target the military, the elderly, and other vulnerable groups.

We found little evidence that payday lenders are harming consumers in Hawai‘i. Complaints have been few, and little information has surfaced about payday lenders encouraging repeated borrowing or engaging in coercive practices. Demand for payday loans is strong, and borrowers who have an immediate need for cash have few better alternatives.

Few complaints

We found little documented evidence of consumer harm in Hawai‘i. Proponents of the bill, such as the Legal Aid Society of Hawai‘i, the Hawaii Asset Building Coalition, and the Hawai‘i Alliance for Community-Based Economic Development did not have data on abuses by payday lenders. Hawai‘i consumer advocates said that those who borrow from payday lenders tend not to complain.

The Consumer Credit Counseling Service of Hawaii said that it had few complaints about payday lenders. The service said that its staff counsels from 1,000 to 1,300 clients a year. Of these, it estimated that about 5 percent, or from 50 to 65 of its clients, has had dealings with payday lenders. Their clients did not report any abusive practices. Staff at the Consumer Credit Counseling Service of Hawaii said that their clients find themselves overwhelmed with debt primarily because of their lack of education and inability to manage their finances and not directly because of payday lenders.

The commerce department’s Office of Consumer Protection also reports that it has had almost no complaints about payday lenders.

No evidence of debt trap in Hawai‘i

When borrowers are unable to repay a loan, they often extend the loan until the next payday by taking out another loan and again paying the applicable fees. The Center for Responsible Lending, a nonprofit advocacy group, calls these rollovers of loans the “debt trap.” Anecdotal evidence of borrowers falling into a debt trap has been documented in other states, but data on the actual incidence and the extent to which rollovers contribute to chronic indebtedness is not known.

The Better Business Bureau of Hawaii does not keep complaint records on payday lenders as a specific category. They are grouped in a general loans category. However, in an advisory issued in March 2005, the Council of Better Business Bureaus warned of the high cost of payday loans. It said, “Cash-strapped consumers can find themselves enmeshed in an endless cycle of repeated borrowing at extremely high costs.”[1] It also stated that Internet payday lending is particularly troublesome because these lenders are hard to locate, they may bypass state usury laws and other consumer protections, and they may expose the borrower to privacy and security risks.

We found no evidence of harm relating to rollovers or of borrowers falling into a debt trap in Hawai‘i. Chapter 480F, HRS, currently prohibits payday lenders from entering into another agreement when an earlier one is in effect or allowing the earlier agreement to be repaid, refinanced, or consolidated with the proceeds from the earlier loan.

Potential for harm

National surveys and studies report that consumers typically take out several payday loans a year. The Center for Responsible Lending says that these loans cost U.S. families $3.4 billion annually. It says that more than 90 percent of the industry's loans are made to people who borrow more than five times a year. Only one borrower in 100 borrows only once a year and pays back the loan the first time.[2] On average, borrowers take out 8 to 13 payday loans a year.[3] When a borrower cannot repay the loan on the due date, the lender renews the same loan and again charges a fee. After a few rollovers, borrowers may find themselves owing more than they had originally borrowed.

A study of payday lenders in North Carolina found that converting more and more occasional users into chronic borrowers significantly enhanced the financial performance of the payday loan industry. The study said that, "In the extreme, the business practices pursued by many payday loan companies can have the same wealth-depleting effect on financially fragile families as other abusive consumer credit practices."[4]

A recent study by the staff of the Federal Deposit Insurance Corporation, however, found that the evidence was not so clear. The researchers noted the dearth of research about the performance and profitability of the payday advance industry. In the study, the authors used proprietary, store-level data from two large payday lenders to determine whether lenders were charging too much and whether rollovers were particularly profitable. They found that fixed operating costs and high loan loss rates justified a large part of the high annual percentage rates charged on payday loans. While high-frequency borrowers accounted for a disproportionate share of a store's loans and profits, the profitability of these companies did not depend on rollovers per se but on maximizing the number of loans made by each store.[5]

Potential harm to the military

A number of articles and studies contend that payday lenders prey on the military. While this may be true on the U.S. mainland, we found little indication of a similar problem here in Hawai‘i.

A recent mainland study of nearly 1,500 payday lenders operating near military bases in 20 states suggested that the demographic characteristics of enlisted military personnel are serious risk factors for personal debt problems. They are young people who often are away from home for the first time. They lack financial experience and tend to borrow with less regard for the long-term consequences. Many are married or single parents with the pressure of child-rearing expenses. Junior enlisted military personnel are low-wage, entry-level personnel, and, like all low-wage workers, they tend to live month-to-month, often struggling to pay their bills. Military surveys reveal nearly a third of enlisted service members reported moderate to severe difficulty in paying their bills.[6]

The study found overwhelming and incontrovertible evidence that payday lenders have been targeting the military. In analyzing the location of payday lenders in 20 states, the authors found that payday lenders are situated at greater densities within three miles of military bases.[7] Several states, such as Virginia and Washington, prohibit payday lenders from contacting the military chain of command in trying to collect a loan or from garnishing military pay.

Hawai‘i has a significant military presence. A mapping of the location of payday lenders on O‘ahu reveals that many have outlets near military bases in Wahiawā near Schofield, Pearl Harbor and Kāne‘ohe. However, those who do consumer credit counseling for the military in Hawai‘i report few complaints about payday lenders. The Fleet and Family Support Center of the U. S. Navy and the U. S. Army Financial Readiness Program both offer financial counseling. They said that they have had few complaints but that payday loans are part of the problem military personnel have in handling their finances.

The director of the Navy and Marine Corps Relief Society in Hawai‘i said that the national headquarters has been tracking payday loans for two years. The society is a self-supporting, nonprofit organization that provides financial support and counseling on almost every Navy and Marine Corps base worldwide. The director stated that military personnel are prime targets for payday lending because they have guaranteed incomes for the term of their enlistment. Service personnel generally repay their loans because these individuals have a strong financial responsibility ethic. Those in debt may lose their security clearance or have other problems with their command. He said that payday lending has been a problem for the military on the U.S. mainland but, so far, it has not been a problem in Hawai‘i.

Some payday lenders in Hawai‘i said that they prefer not to do business with military personnel. They noted that it is difficult to collect from these personnel because they move so frequently, or sometimes the command is indifferent to requests for repayment. Lenders said that sometimes they just let the loan go because they don’t want borrowers to get into trouble with their command.

Abusive collection practices

In other states, payday lenders have been accused of illegal collection procedures, intimidation, and verbally abusive behavior. No evidence of such practices has surfaced in Hawai‘i. Staff at the Consumer Credit

Counseling Service of Hawaii reported that payday lenders have been cooperative in working with them on debt management plans for the service's clients. In their experience, payday lenders have agreed to suppress their interest rates in cases where clients failed to repay payday loans.

Best practices

Those in the payday industry counter the above problems by saying that they abide by the *Best Practices for the Payday Advance Industry* adopted by their national organization, the Community Financial Services Association of America. These best practices require payday lenders to comply with practices such as full disclosure and truthful advertising as well as state laws on rollovers, the customers' right to rescind, and appropriate collection practices.

Payday lenders also say they abide by a separate code of *Military Best Practices* in which they are prohibited from garnishing military wages or contacting the military chain of command to collect on the loan, defer collection against a military customer who has been deployed to a combat posting or called to active duty, and devote a portion of its financial literacy effort to meeting the particular needs of military customers.[8]

Senate Bill No. 1413 too restrictive

The lack of evidence of harm to consumers makes many provisions of Senate Bill No. 1413 unnecessarily restrictive. If enacted, Senate Bill No. 1413 would likely drive Hawai‘i payday lenders out of business by capping any fees or interest charges at 36 percent APR. Payday lenders say that they cannot operate with a 36 percent APR cap. Should the payday lending industry cease to operate in Hawai‘i, the alternatives for consumers are few and may be less desirable.

Proponents of the bill say that more information is needed on the operations and business practices of payday lenders. To accomplish this, Senate Bill No. 1413 imposes a number of reporting requirements on payday lenders such as filing annual reports with the commerce department on their income and expenses, the number of payday loans made, dollar amount of all loans and so on. The bill requires the director of the commerce department to compile an annual report to be submitted to the Legislature and the governor. These provisions would generate considerable paperwork with corresponding demands on the department's staff time to review and analyze the information. At this time, these provisions would require an investment in resources that appears unnecessary. They are unrelated to helping consumers avoid debt, improve management of their finances, or reduce their reliance on payday lenders.

Few Desirable Alternatives

The growth of the payday lending industry clearly illustrates that the demand for these short-term loans is robust and growing. However, banks and other financial institutions no longer offer small, short-term loans. The Community Financial Services Association of America says that payday lenders are meeting a consumer demand by offering short-term credit to those in need. These consumers are often high-risk borrowers with poor credit histories who have few viable alternatives when faced with unexpected expenses.

Overdraft protection

Banks have been reluctant to enter into the payday advance industry. They view these loans as too high risk to be profitable unless offered at extremely high interest rates. They fear that these high rates would invite criticism from consumer advocates and the public.[9] At the same time, banks are offering fee-based draft protection programs that are highly profitable and similar to payday loans. The recent study by Bair at the Isenberg School of Management, University of Massachusetts at Amherst, found that, at the end of 2003, 66 percent of depository institutions offered such programs. The fees charged per overdraft ranged from $17 to $35 per check with the majority ranging from $20 to $25 per overdraft.[10] These programs are functionally equivalent to payday loans and, when used on a recurring basis, they result in an annualized rate that far exceeds those associated with payday loans.

Another recent report from the Center for Responsible Lending found that borrowers are paying more than $10 billion per year for fee-based overdraft protection. These programs are designed to increase the number of overdrafts and increase fee income to the institutions. The center said that overdraft loans are a form of short-term, high-cost credit, and the product is rife with abuses with borrowers paying triple or even quadruple-digit interest rates: "For example, if the overdraft loan fee was calculated as an APR, a $22.50 fee for an $80 overdraft loan translates into a 1,467 percent APR for a loan paid back in a week and a 733 percent APR if the loan is repaid in two weeks."[11]

Users of these overdraft programs are also prone to falling into a debt trap. Federal regulators recently warned against excessive use of overdraft loans since the vast majority of these loans are to repeat users. Available data show that from 20 to 27 percent of borrowers incur these fees at least twice a month or 24 times a year. Nine to 13 percent are charged these fees at least 6 times per month or 27 times a year.[12] Payday loans may actually be less expensive than these fee-based overdraft protection services offered by banks and credit unions.

Internet lending

Those who need ready cash would likely resort to Internet payday lenders should Hawai'i lenders stop offering payday advances. Websites offering payday advances are proliferating. These websites impose minimal requirements on borrowers and promise to deposit cash in their checking accounts within the hour. Borrowing from Internet lenders is even more problematic than borrowing from local storefronts. A recent study of Internet payday loan sites found that loans are marketed, delivered, and collected online at rates and terms that mire customers in repeated borrowing at extremely high costs.[13]

In a sample of 100 Internet sites offering payday loans, the study found loan rates ranging from 650 percent to 780 percent APR with automatic, built-in rollovers in many contracts. The study said that, "The online payday loan industry is a confusing mix of lender sites, referral sites, and layers of click-through entities. Consumers who click through links on referral sites may have no idea of who is making the actual loan or collecting their personal information."[14] Customers of these sites are at additional security risk by providing access to personal bank accounts and making and receiving payments via electronic funds transfers. Customers fill out forms online without knowing where the information goes or how secure it is. They may find their identities stolen or withdrawals made from their checking accounts without their knowledge. Many sites use services that hide their ownership and location. Some operate from Grenada or other foreign countries that make it difficult to locate and communicate with lenders to resolve disputes.

In addition, attempts to control Internet lending leads to questions of jurisdiction and enforcement. States are just beginning to come to grips with regulatory issues relating to loans made to consumers by out-of-state lenders. Some states have adapted credit laws to cover loans made over the Internet. Other states, such as New Mexico, require out-of-state lenders to be licensed to make such loans. Oklahoma specifically amended its statute in 2004 to apply to loans made over the Internet.[15] Hawai'i has yet to wrestle with the issue of Internet commerce.

Educational alternatives

Some proponents of the bill suggest that payday lenders should help to support financial education. They believe that this would assist consumers to gain financial literacy and avoid debt.

The Bair study concluded that, "Increasingly, Americans must rely on their own abilities to accumulate and manage financial assets. The rapid growth of the payday industry is a symptom of the problem, not the cause of the disease. A payday loan is what it is: a high-cost form of small dollar, short-term credit that credit-impaired customers want and need given the comparatively higher cost of NSF [nonsufficient funds] or late fees and the lack of lower-cost credit alternatives. The escalating demand for the product reflects the woeful inability of millions of Americans to effectively manage their finances and accumulate savings.”[16]

However, studies have found financial education to be of limited benefit to those who chronically misuse debt. Intensive programs have been of some value but have been too expensive and too demanding of consumers. In a study on predatory lending focusing on home mortgage lending, the U.S. General Accounting Office (now called the Government Accountability Office) found that consumer education by itself has limits as a tool for deterring predatory lending.[17] It found that a number of state and federal agencies as well as nonprofits have funded consumer education programs. However, these programs are unlikely to provide consumers with sufficient information to properly assess whether a loan contains abusive terms. In addition, even a clear system of disclosures may be of limited value to unsophisticated borrowers who are not highly educated.

A promising alternative

The Bair study found that the most effective alternative to be one implemented by a North Carolina credit union. It offers a Salary Advance Program or a revolving loan program that allows a maximum loan balance of $500 at an interest rate of 12 percent per annum. The customer is expected to repay the loan in full on the member’s next payday. The loan has a mandatory savings component requiring that 5 percent of each advance be placed in a special savings account. This is designed as an incentive for members to accumulate savings until they no longer need to resort to borrowing; thus, the more they borrow, they more they save.

The Credit Union National Association has stated that it is committed to providing a safe and affordable alternative to predatory payday lenders. The association said that credit unions across the country have implemented various programs to provide those in their communities with alternatives. Hawai‘i has 94 credit unions statewide. Unfortunately, each one operates with its own board and makes its own decisions. The national association can only encourage the credit unions to provide an alternative to payday loans.

A year ago, the Windward Community Federal Credit Union in Hawai‘i began offering its members quick, small loans at an interest rate of 10.9 percent APR. It said that such loans are an extension of its personal loan program using standard loan documentation. Loan officers make credit checks, review pay stubs, and require borrowers to fill out a loan application and sign a security agreement. Borrowers receive the cash immediately and repay the loans in installments over a period of several months. The credit union said that it does not make money on these loans nor does it have a high loss rate on the loans. It has assumed a slightly higher risk to provide a community service. Currently, the credit union has a very small volume of these loans, and it does not advertise them.

Suggested Amendments to Chapter 480F, HRS

In the absence of evidence of actual harm to consumers in Hawai'i, but with the possibility of harm, it would be appropriate to make minimal changes to Chapter 480F, HRS. The law should be amended to add clearer disclosure requirements, a lower cap on fees, and a mandatory registration program. These changes would make the law more consumer-friendly and enable the State to track those who offer payday-lending services in Hawai'i.

Clearer disclosure requirements

Currently, Section 480-2, HRS, requires any person who cashes a check to post, in a conspicuous place, a notice that sets out the fees charged for cashing a check and where a consumer might file complaints with the commerce department. The law does not specifically state that these provisions also pertain to deferred deposit agreements or payday loans. We found that not all stores making payday loans had the fees posted or had notices relating to filing complaints with the commerce department. Therefore, Section 480-2, HRS, should be amended to specifically require payday lending stores to post the fees and annual percentage rates charged for payday loans and information on where to file complaints.

Lower fee cap

Hawai'i consumers are unlikely to obtain cheaper loans through price competition. However, Hawai'i's law could be more consumer-friendly by lowering the cap on fees that payday lenders can charge.

The Bair study found that there is little price competition in the payday loan industry since lenders generally charge the maximum allowed by the states in which they operate. We found this to be true in Hawai'i where almost all payday lenders charge the same fees. The study said that, "this may suggest that payday loans are efficiently priced as compared to the relatively high operational costs associated with the product."[18] Generally, payday lenders compete in terms of location and convenience. The author also suggests that customers are sufficiently desperate for cash that the immediacy of the product is more important than the price paid.

Hawai'i currently allows payday lenders to charge a fee of 15 percent of the face value of the postdated check. This allows them to charge $17.65 or an APR of 459 percent for a cash advance of $100 for 14 days. Six states currently allow an APR of 459 percent; eight states allow a maximum APR of 390 percent. (See Exhibit 1.1.) To derive an APR of 390 percent, payday lenders would charge a fee of $15 per $100 (borrower writes a check for $115 and receives $100 in cash).

It is clear that payday lenders can operate with an APR of 390 percent since several large, national, payday-lending corporations operate in states with a 390 percent APR cap. In Texas, with a lower APR of 309 percent, large payday lenders have shifted from payday lending to calling themselves Credit Service Organizations and offering alternative products that have a higher fee.

Payday lenders say that the charges for payday loans are reasonable in view of the high-risk nature of their loans. It is reasonable to expect that those who have poor credit have to pay more for their loans. However, indications are that the payday lenders could still profitably stay in business in Hawai‘i under a reduced rate cap somewhere between 309 percent and 390 percent APR.

In addition to reducing the fee cap, the law should be amended to clarify that any fee charged must include any and all other charges. Some payday lenders are said to charge a general excise tax in addition to the fee.

Mandatory registration

It is difficult to identify all the payday lenders who currently operate in Hawai‘i since some of them are not registered as businesses at the Business Registration Division at the commerce department. The implementation of a simple mandatory registration program would generate a list of all the payday lenders, the location of their outlets, ownership information, and the names and addresses of principals of the business. Only 4 of the 37 states that regulate payday lenders have no licensing requirement and most of them have additional requirements such as bonding. Mandatory registration would enable Hawai‘i to take the preliminary steps to addressing the rising concern over the potential for harm from payday lenders without imposing prelicensure or other qualification requirements. A simple mandatory registration program would impose only minimal fees on payday lenders and would not present any significant workload increase at the Department of Commerce and Consumer Affairs.

Conclusion

We conclude that there is little evidence that payday lenders have harmed Hawai‘i consumers. At the same time, other states do have evidence of harm. The majority of other states license payday lenders. It would be prudent to amend Chapter 480F, HRS, to require payday lenders to provide full disclosures, to establish a lower fee cap for consumers, and to register with the Department of Commerce and Consumer Affairs. These minimal changes would enable the State to keep track of payday lenders and to make their operations more consumer-friendly.

Recommendations

We recommend that Chapter 480F, HRS, be amended to accomplish the following:

1. Require check cashers or payday lenders who enter into deferred deposit agreements (payday loans) to post in a conspicuous place any and all fees that they charge for such an agreement including the annual percentage rate for the loan.

2. Reduce the maximum fee for a deferred deposit agreement.

3. Institute a mandatory registration program for all payday lenders to register their businesses with the Department of Commerce and Consumer Affairs. The information should include proof of business registration with the department, the names of the owners of the company, the names and addresses of the principals of the businesses, and the names and locations of all stores.

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Notes

Chapter 1

1. Center for Responsible Lending, “The Debt Trap of Payday Lending,” *CRL Issue Brief No. 19*, September 16, 2004.

2. Community Financial Services Association of America, General Information, *The Payday Advance Industry Overview*, http://www.cfsa.net/genfo/ageninf.html

3. *Ibid.*

4. Lawrence Meyers, “Can Payday Lenders Survive,” The Motley Fool, Fool.com. May 16, 2005.

5. Advance America, Cash Advance Centers, Inc., *Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act or 1934 for the Year ended December 31, 2004*, United States Securities Exchange Commission, Form 10-K, p. 4, 34.

6. *Ibid.*, p. 8.

7. *Ibid.*, p. 22.

8. Sheila Bair, *Low-Cost Payday Loans: Opportunities and Obstacles*, Isenberg School of Management University of Massachusetts at Amherst, June 2005.

9. Advance America, *op. cit*.

10. *Ibid.*, p. 7.

11. Federal Deposit Insurance Corporation, *Guidelines for Payday Lending*, Financial Institution Letters, FDIC: FIL-14-2005: Guidelines for Payday Lending.

12. Note that information may be incomplete.

13. See paydayhawaii.com/locations.html.

14. Benjamin Shimberg and Doug Roederer, *Questions a Legislator Should Ask*, Second Edition, The Council on Licensure, Enforcement and Regulation, Lexington, Kentucky, 1994.

Chapter 2

1. *"High Cost Payday Lenders Advertise Everywhere."* Council of Better Business Bureaus, Inc., March 2, 2005.

2. Center for Responsible Lending, "Fact vs. Fiction: the Truth about Payday Industry Claims," 2005, www.responsiblelending.org/payday/factfiction.cfm.

3. Keith Ernst, John Farris, Uriah King, *Quantifying the Economic Cost of Predatory Payday Lending*, A report from the Center for Responsible Lending, December 18, 2003, February 24, 2004, p. 2.

4. Michael A. Stegman and Robert Faris, "Payday Lending: A Business Model that Encourages Chronic Borrowing, "*Economic Development Quarterly*, vol.17, No.1, February 2003, p. 98-32.

5. Mark Flannery and Katerine Samolyk, *Payday Lending: Do the Costs Justify the Price?* FDIC Center for Financial Research Working Paper No. 2005-9, June 2005.

6. Peterson, Christopher Lewis and Graves, Steven M., "Predatory Lending and the Military: The Law and Geography of 'Payday' Loans in Military Towns" (March 28, 2005). http://ssrn.com/abstract=694141.

7. *Ibid*.

8. Community Financial Services Association of America, *Best Practices for the Payday Advance Industry* and *Military Best Practices.* Washington, D.C., 2005.

9. Sheila Bair, *Low-cost Payday Loans: Opportunities and Obstacles,* Isenberg School of Management, University of Massachusetts at Amherst, June 2005, p. 10.

10. *Ibid.* p. 11.

11. Jacqueline Duby, Eric Halperin, Lisa James, "High Cost and Hidden from View: The $10 Billion Overdraft Loan Market," *CRL Issue Paper No. 9*, Center for Responsible Lending, May 26, 2005, p. 2.

12. *Ibid.* p. 5.

13. Jean Ann Fox and Anna Petrini, *Internet Payday Lending: How High-priced Lenders Use the Internet to Mire Borrowers in Debt and Evade State Consumer Protections,* Consumer Federation of America, November 30, 2004.

14. *Ibid.*, p. 12.

15. Okla. Stat. Tit. 59 Sec.3103.C.

16. Bair, *op cit.* p. 38.

17. U. S. General Accounting Office, *Consumer Protection, Federal and State Agencies Face Challenges in Combating Predatory Lending*, January 2004.

18. Bair, *op. cit*., p. 29.

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Response of the Affected Agency

Comments on Agency Response

We transmitted a draft of this report to the Department of Commerce and Consumer Affairs on December 13, 2005. A copy of the transmittal letter to the department is included as Attachment 1. The response of the department is included as Attachment 2.

The department made several comments: initial registration of business entities generally does not require disclosure of the nature of the business, businesses are not required to follow any standard industry classification when declaring the nature of their business, and ownership information is not required to be reported in business filings. The department concluded that it cannot therefore generate a list of payday lenders even if registration were mandated. The department noted that these practices are consistent with modernized business statutes in other states.

We believe that the department's Business Registration Division already offers services to the public regarding the businesses registered with it. The division maintains a public registry of over 90,000 active business entities that it makes available to the public to support the extension of trade credit, commercial leases, real estate transactions, and the delivery of financial services. It issues "Certificates of Good Standing" to businesses that are registered. It responds to public inquiries for information, usually including the names of the principals, officers or directors or partners and the registrant's address. It also maintains business records and provides for compliance review. Requiring the registration of payday lenders, with an appropriate fee for registering, should not pose a new or uncompensated burden for the department.

ATTACHMENT 1

STATE OF HAWAII
OFFICE OF THE AUDITOR
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

MARION M. HIGA
State Auditor

(808) 587-0800
FAX: (808) 587-0830

December 13, 2005

COPY

The Honorable Mark E. Recktenwald
Director
Department of Commerce and Consumer Affairs
King Kalakaua Building
335 Merchant Street
Honolulu, Hawai`i 96813

Dear Mr. Recktenwald:

Enclosed for your information are three copies, numbered 6 to 8, of our confidential draft report, *Sunrise Analysis: Check Cashing and Deferred Deposit Agreements (Payday Loans)*. We ask that you telephone us by Thursday, December 15, 2005, on whether or not you intend to comment on our recommendations. If you wish your comments to be included in the report, please submit them no later than Monday, December 19, 2005.

The Governor and presiding officers of the two houses of the Legislature have also been provided copies of this confidential draft report.

Since this report is not in final form and changes may be made to it, access to the report should be restricted to those assisting you in preparing your response. Public release of the report will be made solely by our office and only after the report is published in its final form.

Sincerely,

Marion M. Higa

Marion M. Higa
State Auditor

Enclosures

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR

MARK E. RECKTENWALD
DIRECTOR

LAWRENCE M. REIFURTH
DEPUTY DIRECTOR

STATE OF HAWAII
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December 19, 2005

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OFC. OF THE AUDITOR
STATE OF HAWAII

State of Hawaii
Office of the Auditor
Marion M. Higa, State Auditor
465 S. King Street, Room 500
Honolulu, Hawaii 96813-2917

Dear Ms. Higa:

Reference is made to your letter, dated December 13, 2005, enclosing copies of your confidential draft report, *Sunrise Analysis: Check Cashing and Deferred Deposit Agreements (Payday Loans)*.

We have reviewed the report and our Business Registration Division has the following comments regarding the mandatory registration recommendation contained on page 22 of the report:

1. Initial registration of business entities in Hawaii does not require that the "nature of business" be disclosed. The only exception is the registration of a new trade name, which technically are not business entities. For all the other business entity types, it is only in the annual renewal filing that an entity provides such information. Please note that providing the "nature of business" at renewal is only mandatory for corporations. Providing the "nature of business" at renewal is optional for all other business entity types.

2. The Business Registration Division does not require that businesses follow any standard industry classification when declaring "nature of business." A filer may describe the business in any manner and therefore businesses of the same nature may possibly be identified in different ways (e.g., medical services, physician's office, doctor's office, medical clinic, etc.).

3. Ownership information of business entities is generally not required to be reported in business filings with the business registry.

Accordingly, under current business registration laws, it would not be possible for the Business Registration Division to generate a comprehensive list of payday lenders even if registration is mandated as recommended in the report. Please note that the information maintained in the

Hawaii's business registry is consistent with the practices of other states. The department began the process of modernizing the business laws ten years ago by conforming the Hawaii's laws to model business statutes. This has resulted in the most modern business laws in the history of the state. Any amendment to the business laws to require disclosure of information not currently required may be regarded as an additional burden to doing business in Hawaii and result in an adverse effect to commercial activity in the state.

If you require any additional information, please contact Corinna Wong, Commissioner of Securities, at 586-2744.

Very truly yours,

Mark E. Recktenwald
Director

C: Ms. Corinna M. Wong