

The Florida Senate
BILL ANALYSIS AND FISCAL IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: The Professional Staff of the Banking and Insurance Committee

BILL: SB 2638

INTRODUCER: Senator Baker

SUBJECT: Credit Enhancement Loans

DATE: April 12, 2008 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	Johnson	Deffenbaugh	BI	Pre-meeting
2.			CM	
3.			CM	
4.			FT	
5.			GA	
6.				

I. Summary:

The bill authorizes credit enhancement loans, creates licensure requirements for persons providing such loans, and designates the Department of Financial Services as the regulator of entities engaged in these loan transactions. Credit enhancement loans are loans in an amount of \$3,000 or less with a maximum interest rate of 19.9 percent per year, excluding one-time fees and monthly fees authorized under the bill.

This bill creates an undesignated section of the Florida Statutes.

II. Present Situation:

The Office of Financial Regulation (office) has regulatory authority over small consumer loan programs authorized under chapter 516 (consumer finance), chapter 537 (title loans), and chapter 560, (deferred presentment transactions or payday loans). Each of these loan programs provides an exception from the 18 percent per year simple interest cap that is set forth in s. 687.02, F.S.

Types of Lenders Providing Small Consumer Loans

Consumer Finance Loans -- Under Chapter 516, F.S, the Florida Consumer Finance Act, a consumer can borrow up to \$25,000 at the same rates of interest provided under the current Title Loan Act (i.e., maximum of 30 percent per year). Licensees may charge a maximum interest rate of 30 percent per year, computed on the first \$2,000 of the principal amount; 24 percent per year on that part of the principal amount exceeding \$2,000 but not exceeding \$3,000; and 18 percent per year on that part of the principal amount exceeding \$3,000. The annual percentage rate (APR) must be computed and disclosed as required by the federal Truth in Lending Act and

Regulation Z. The act allows a licensee to charge a borrower up to \$25 for the costs of a credit check and an annual fee of \$25 on the anniversary date of the line-of-credit account.

The license fees under the act are \$825 for the initial application and \$625 for a renewal. A licensee must maintain evidence of liquid assets of at least \$25,000. The office is authorized to examine and investigate any licensee, and take disciplinary actions against licensees violating the act. Currently, there are 500 locations in Florida.

Deferred Presentment Transactions (“Payday Loans”) – A payday loan is another loan product that is available under part IV of Ch. 560, F.S. A consumer can obtain a payday loan by providing a personal, postdated check. When the loan is due, the lender cashes the check or, if the borrower cannot repay it, may renew the loan. The check is held for a minimum of 7 days, but not longer than 31 days. The amount of the loan may not exceed \$500. The fees allowed for a payday loan are 10 percent of the loan amount plus a verification fee, which may not exceed \$5. For a \$500 payday loan with a term of 30 days, the consumer would pay \$55 in fees, which is an effective rate of interest of 134 percent.

Payday lenders are prohibited from taking additional collateral and engaging in rollover transactions. Other consumer protections for payday loans include a 24-hour waiting period between transactions and a detailed deferred presentment agreement. There is also a 60-day grace period if the consumer notifies the vendor before the due date that the consumer is unable to make the check good. In these cases, the consumer must participate in credit counseling in order to be afforded the grace period. The office maintains a statewide database to ensure that consumers do not have more than one outstanding payday loan at any one time and that they adhere to the 24-hour waiting period. There are over 1,200 payday lender locations in Florida.

In order to transact business as a deferred presentment provider, a person must be licensed under Part II (funds transmitters and payment instrument sellers) or Part III (check cashers and foreign currency exchangers) of Chapter 560, F.S. In addition to the licensing fee and renewal fees associated with a Part II or Part III license, the person must pay a \$1,000 fee to file a notice of intent to engage in deferred presentment transactions, and must renew the notice of intent biennially. The renewal fee is \$1,000.

Title Loans -- A title loan is a loan secured by bailment of a certificate of title to a motor vehicle. The office is responsible for enforcing the act under the provisions of ch. 537, F.S. Prior to engaging in title loan lending, a person must secure a license through the office by submitting a nonrefundable application fee of \$1,400. Licensees must maintain a bond, certificate of deposit, or letter of credit of \$100,000 per location. Currently, there are no licensed title loan lenders in Florida.

The maximum interest rate is 30 percent per year. No other fee may be charged for a title loan, and a title loan lender is expressly prohibited by the act from advertising the loans as “interest free” or “no finance charge.” The law provides for a 30-day loan term with unlimited rollovers of the loan. The same rates of interest as described above apply to rollover transactions.¹ All loans

¹ Section 537.011, F.S.

require a written contract, which includes certain information about the borrower and the terms of the loan.²

Pawnbroking -- Pawnbroking transactions are regulated under ch. 539, F.S. A pawn is defined to mean “. . . any advancement of funds on security of pledged goods on condition that the pledged goods are left in the possession of the pawnbroker for the duration of the pawn and may be redeemed by the pledgor . . .”³ The pawnbroker is entitled to pawn service charge in which the interest component of such charge is 2 percent of the amount financed for each 30-day period. The pawnbroker may charge any amount of pawn service charge, so long as the total amount, inclusive of the interest rate, does not exceed 25 percent of the amount financed for each 30-day period, except that a pawnbroker is entitled to receive a minimum pawn service charge of \$5 for each 30-day period.⁴

Federal Truth in Lending Act

The Truth in Lending Act (TILA) is intended to ensure that credit terms are disclosed in a meaningful way so consumers can compare credit terms.⁵ Regulation Z, which was adopted by the Board of Governors of the Federal Reserve System, implements TILA. TILA requires creditors to disclose the cost of credit as a dollar amount (finance charge) and as an annual percentage rate (APR). Finance charges include any charges or fees payable by the consumer and imposed by the as an incident to or as a condition of an extension of consumer credit.

III. Effect of Proposed Changes:

Licensure Requirements

A nonrefundable application fee of \$2,500 must be submitted to the Department of Financial Services (department). The applicant must have a net worth of at least \$1 million. The department is required to act on a completed license application within 90 days of the submission date. If the department does not approve, deny, or grant an extension within 90 days, the application is deemed approved.

A licensee may operate only at locations that are approved by the department. A change of location requires prior written notice to and approval by the department. If certain subsequent changes in the ownership or other information occur, the licensee is required to notify the department within 30 days of such change.

Interest Rate and Terms of a Credit Enhancement Loan

This bill would permit an entity licensed by the department to make a loan in an amount not to exceed \$3,000 with an interest rate of 19.9 percent for a minimum term of 3 months. In addition to an interest rate of 19.9 percent simple interest per year, the following fees would be permitted:

- A maximum monthly processing fee of \$15;
- A maximum monthly maintenance fee of \$15;

² Section 537.008, F.S.

³ Section 539.001(1)(h), F.S.

⁴ Section 539.001(11), F.S.

⁵ 15 U.S.C. 1601, et seq.

- A maximum one-time underwriting fee of \$10;
- A maximum late payment fee of \$25, and a
- \$30 returned check fee.

The minimum monthly payment required for a loan would be the greater of \$25 or interest earned plus 4 percent of the outstanding loan balance. Only one loan is permitted at a time from any one company or any of its affiliates, subsidiary, or parent.

Loan Process

A licensee is required to determine the credit worthiness of each customer in accordance with industry-accepted proprietary credit models. When a customer applies for a loan, the licensee is required to provide the following information to the customer:

- The impact timely payments and late payments have on a consumer's credit score and interest rates on loans.
- Locations where consumers can receive free financial literacy information.

The bill prohibits a licensee from denying a loan based on the race, color, religion, national origin, gender, or marital status of the applicant or any other person connected with the transactions. Currently, under the federal Equal Credit Opportunity Act, it is unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction, on the basis of race, color, religion, national origin, sex, marital status, age, or because the applicant receives income from a public assistance program.⁶

The bill prohibits a licensee from engaging in any unfair method of competition or unfair or deceptive trade practice in providing such loans or services in collecting money allegedly owed by a customer. However, the bill does not specify that such an unlawful practice is a violation under part II of ch. 501, F.S., the Florida Deceptive and Unfair Trade Practices Act.

A licensee is prohibited from accepting an assignment of earnings of a customer for payment or as security for payment of a loan. A credit enhancement loan may not be secured by real property.

The bill requires licensees to report on a periodic basis, based on accepted industry standards, credit related data to the major credit bureaus in order to assist customers who pay in a timely manner to rebuild their credit histories. The bill directs the licensee to graduate customers to interest rates or terms that are more favorable or terms, based on positive payment histories. A licensee is required to offer and encourage its customers to participate in programs designed to enhance their financial literacy.

Any contract for the extension of credit, the making or collecting of which violates this act, except accidental errors or errors of computation, is void. The bill provides that, in the event a monetary judgment is obtained against a customer, the interest rate on the judgment and the loan balance is capped at 8 percent per year from the date of the judgment.

⁶ 15 U.S.C. 1691 *et seq.*

Regulatory Oversight

The department is authorized to examine the financial books and records of the licensee directly relating to credit enhancement loans made as reasonably required by the department. A licensee is required to reimburse the department for all examination costs incurred by the department in conducting an examination.

A licensee is required to submit an annual report to the department on or before March 31 for the prior calendar year. The report must disclose any changes in the information contained in the original application and other information necessary to document compliance with this act.

The department is authorized to issue subpoenas and exercise other specified powers necessary to discharge its duties. If the department has reasonable cause, supported by credible evidence, to believe that a person is violating this act, it may enter an order requiring the person to desist or refrain from such violation. Any person aggrieved by a rule or order of the department may appeal to the department within 60 days after such rule or order is adopted pursuant to ch. 120, F.S.

The department is authorized to suspend or revoke a licensee, after due notice and a hearing, if the licensee or an officer, director, agent, or an employee of a licensee :

- Materially fails to comply with any rule or order of the department;
- Materially fails or refused to many any required report;
- Fails to pay any required fee; or
- Knowingly furnishes false or misleading information to the department.

A violation of this act is a misdemeanor of the second degree for a first offense, and a misdemeanor of the first degree for a second or subsequent offense. Each violation of this act is a considered a separate offense.

The department is authorized to adopt rules to administer this act.

The act takes effect on July 1, 2008.

IV. Constitutional Issues:**A. Municipality/County Mandates Restrictions:**

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Fiscal Impact Statement:

A. Tax/Fee Issues:

The bill creates a new licensure program within the Department of Financial Services for entities that make credit enhancement loans. The licensure fee is \$2,500. Renewals fees are not addressed in the bill.

B. Private Sector Impact:

An applicant for licensure must have a minimum net worth of \$1 million. In contrast, other consumer finance lenders, such as an entity licensed under ch. 516, are required to have liquid assets of \$25,000. The significantly higher net worth requirement and licensure fee could serve as a barrier to entry for potential lenders providing credit enhancement loans.

Depending upon a number of factors such as length of the loan, the amount of the loan, whether the consumer only makes minimum payments, etc., the total cost of credit for these loans could be very high. The Office of Financial Regulation provided the following information, which summarizes the interest and fees at various borrowing levels, assuming minimum payments are made:

CREDIT ENHANCEMENT LOANS					
Amount Borrowed	\$300	\$500	\$1,000	\$2,000	\$3,000
Loan Costs (19.9% and Fees)	402.34	697.06	975.58	1,191.17	1,406.75
Effective Interest Rate*	204%	129%	77%	50%	40%
Assumptions:					
Minimum Payments Required**	\$25	\$25	\$40	\$80	\$120
Number of Months to Repay	12	20	25	25	25
*(\$25 or 4%, whichever is greater)					
Costs of Financing:					
Interest	\$32.34	\$87.06	\$365.58	\$581.17	\$796.75
Fees	<u>370.00</u>	<u>610.00</u>	<u>610.00</u>	<u>610.00</u>	<u>610.00</u>
Total Interest and Fees	\$402.34	\$697.06	\$975.58	\$1,191.17	\$1,406.75

*The effective interest rate is the annual rate of interest that accounts for the effect of interest compounding more often than once a year.

C. Government Sector Impact:

The Office of Financial Regulation (office) provided information concerning the fiscal impact of implementing the bill since the department does not regulate any consumer loans. The office estimates that 10 companies with 300 to 400 locations would seek licensure in Florida. Since this is a new type of consumer loan program, the office estimates believes each office would need to be examined because each office location

would be licensed separately. The bill provides that licensees are responsible for reimbursing the department for the costs of examinations.

The office estimates that the addition of a regulatory program, and thus, a new license type to the automated REAL System will require programming changes and three additional positions will be needed to administer the program. The office provided the following estimated fiscal:

	FY 07-08	FY 08-09	FY 09-10
Recurring Revenues and Expenditures			
Revenues: Application Fees (biennial)		\$750,000	
Expenditures: Salaries, Benefits, and Expenses		230,228	\$230,228
Nonrecurring Expenses:			
Expense		10,184	
Other Capital Outlay		7,500	
Contracted Services (REAL System programming changes)		153,000	
Total Nonrecurring Expenses		\$170,664	

VI. Technical Deficiencies:

The bill requires the Department of Financial Services to regulate persons who offer these loans. However, the Office of Financial Regulation is responsible for regulating consumer finance loans, deferred presentment provider loans (payday loans), and title loans.

The term, “credit enhancement loan,” is not defined in the bill nor are other terms used in the bill. Definitions of certain terms would aid in clarifying any requirements under the section to licensees, customers, and the regulator. The regulator is granted rulemaking authority to adopt rules to administer the section, but the creation of definitions for use in the section could be outside of this authority.

The regulator is authorized to examine but not to investigate entities subject to regulation under this act. The bill permits the regulator to examine records directly relating to credit enhancement loans made as reasonably required by the department. Licensees are required to maintain financial books and records for a maximum of 2 years. Generally, other regulated entities are required to maintain records for at least 3 to 5 years. Therefore, this would prevent the regulator from conducting a comprehensive examination under the provisions of this bill, despite the many requirements and safeguards provided. Usually, the types of records are specified in law or an agency is authorized to adopt rules specifying such records.

Additionally, the bill requires an annual report to be filed with the regulator, but does not address or authorize any action to be taken by the regulator upon receipt of this report. In order to ensure that an entity is complying with provisions of this section, the regulator should be given authority to ensure compliance with the requirements set forth.

The bill prohibits a borrower from having more than one outstanding loan at a time with a licensee or its affiliate, subsidiary, or its parent. However, it would be difficult for the regulator or another lender to ascertain the number of loans a borrower had. It would not prevent a borrower from securing one or more loans from unrelated licensees. The bill does not require the maintenance of such transactions in a central database accessible by the regulator or lenders.

The bill does not authorize the regulator to impose administrative fines if the licensee violates any provision of the act, such as the interest rate or fee caps provided in the bill. This limits the regulator's ability to enforce the requirements of the section to license revocation or suspension. A fine for violations of the section, and rules adopted to administer it, should be added to the bill. Additionally, the bill does not specify where any monies collected should be deposited or allocated.

The bill requires an applicant for licensure to have a minimum net worth requirement, on a consolidated basis, of at least \$1 million. However, the bill does not require applicants to submit audited financial statements to substantiate the net worth requirement at the time of licensure or periodically after licensure to document that the net worth requirement has been met.

The office expressed concerns regarding the applicability of the Florida Administrative Procedures Act (APA), which is codified in chapter 120, F.S. The bill specifies procedures regarding licensing decisions, requests for hearings, and rule challenges. The bill appears to delineate specific provisions of the APA in some sections and deviate from it in others. The bill should be amended to remove references to procedures that are subject to the APA, unless a particular policy reason exists for deviation from Ch. 120, F.S.

The bill provides that a loan made outside of Florida after July 1, 2008, in an amount of \$3,000 or less which carries a greater charges than authorized by the act is not enforceable in Florida. It is unclear whether this provision applies to residents of Florida that transact business with companies located outside of Florida.

VII. Related Issues:

The bill does not require credit enhancement loans to disclose the annual percentage rate of the loans in accordance with TILA. It is the opinion of the office that credit enhancement loans are subject to TILA and Regulation Z. The office recommends that a reference to compliance with these laws be added to the bill so that the office would have the authority to take an enforcement action if the licensee violated those disclosure requirements.

VIII. Additional Information:

A. Committee Substitute – Statement of Substantial Changes: (Summarizing differences between the Committee Substitute and the prior version of the bill.)

None.

B. Amendments:

None.

This Senate Bill Analysis does not reflect the intent or official position of the bill's introducer or the Florida Senate.
