HOUSE OF REPRESENTATIVES STAFF ANALYSIS

BILL #: HB 1081 Consumer Loans
SPONSOR(S): Burton and others
TIED BILLS: **IDEN./SIM. BILLS:** SB 1012

REFERENCE	ACTION	ANALYST	STAFF DIRECTOR or BUDGET/POLICY CHIEF
1) Insurance & Banking Subcommittee	8 Y, 3 N	Bauer	Cooper
2) Regulatory Affairs Committee			

SUMMARY ANALYSIS

The Florida Office of Financial Regulation (OFR)'s Division of Consumer Finance is responsible for the licensing and regulation of non-depository financial service entities and individuals, and conducts examinations and compliance investigations for licensed entities to determine compliance with Florida law. One of the regulatory programs administered by OFR is the Florida Consumer Finance Act (ch. 516, F.S., "the Act"), which sets forth licensing requirements for consumer finance lenders and the terms and conditions under which a consumer finance loan is permitted in Florida. The Act sets forth maximum interest rates for *consumer finance loans*, which are "loan[s] of money, credit, goods, or a provision of a line of credit, in an amount or to a value of $25,000 or less at an interest rate greater than 18 percent per annum. The allowable interest rates on consumer finance loans are tiered and limited based on the principal amount that falls within each tier of the loan. As the principal amount increases, the allowable interest rate decreases. Pursuant to federal law, the annual percentage rate (APR) for each consumer finance loan must be computed and disclosed to the borrower.

The bill creates an alternative small loan option under the Act, referred to as a *consumer installment loan*, with principal amounts ranging between $300 and $2,000 and terms of 6-24 months. Under current law, loans in these amounts would normally be subject to the 30% interest rate. Instead, the bill allows licensed lenders to charge "nonrefundable processing fees" and "installment loan handling charges" expressed in flat dollar amounts or percentages in proportion to the loan principal. As calculated, the APR on these alternative consumer installment loans are generally higher than consumer finance loans under current law. Additionally, the bill:

- Permits specified certain fees or charges, but does not authorize insurance premiums, unlike consumer finance loans under current law.
- Permits a borrower to cancel an installment loan up to 5 days after the loan is made, and requires the lender to "promptly" refund all fees and charges to the borrower.
- Permits licensed lenders to compensate persons for referring loan applicants, so long as those referral fees are not charged to the borrower.
- Provides that borrowers who repay installment loans in full with cash, a new loan, or a renewal of the existing loan at least 30 days before the date that the final installment is due, the licensee must refund or credit the unearned portion of any *loan handling charge* made in connection with the loan.

The bill does not have a fiscal impact on state or local government. The bill has an indeterminate impact on the private sector, in that while it may provide another source of non-bank credit for consumers, the rate of borrower default and subsequent re-borrowing cannot be projected.

The bill provides an effective date of July 1, 2015.

FULL ANALYSIS

I. SUBSTANTIVE ANALYSIS

A. EFFECT OF PROPOSED CHANGES:

Current Situation

State Regulation of Consumer Loans

The Florida Office of Financial Regulation (OFR)'s Division of Consumer Finance is responsible for the licensing and regulation of non-depository financial service entities and individuals, and conducts examinations and compliance investigations for licensed entities to determine compliance with Florida law. One of the regulatory programs administered by OFR is the Florida Consumer Finance Act (ch. 516, F.S., "the Act"), which sets forth licensing requirements for consumer finance lenders and the terms and conditions under which a consumer finance loan is permitted in Florida. The Act sets forth maximum interest rates for *consumer finance loans*, which are "loan[s] of money, credit, goods, or a provision of a line of credit, in an amount or to a value of $25,000 or less at an interest rate greater than 18 percent per annum.[1]"

Consumer finance loans may be secured or unsecured. The allowable interest rates on consumer finance loans are tiered and limited based on the principal amount that falls within each tier of the loan. As the principal amount increases, the allowable interest rate decreases. In 2013, the Legislature increased the principal amounts that would be subject to the maximum amount of interest within each tier, so that consumer finance lenders licensed with the OFR may charge a maximum interest rate of:

- 30% a year, computed on the first $3,000 of the principal amount,
- 24% a year on that part of principal between $3,001 to $4,000, and
- 18% per year on that part of principal between $4,001 to $25,000.[2]

These principal amounts are the same as the financed amounts determined by the Federal Truth-in-Lending Act (TILA), and Regulation Z (Reg Z) of the Board of Governors of the Federal Reserve System.[3] The maximum interest rates and finance charges under the Act are computed on a simple-interest basis, and not a compounding or other basis. The APR for all loans under the Act may equal, but cannot exceed, the APR for the loan as required to be computed and disclosed by TILA and Reg Z.[4]

Other than the applicable interest rates described above, the Act allows consumer finance lenders to charge borrowers the following charges and fees[5]:

- Up to $25 for investigating the credit and character of the borrower,
- A $25 annual fee on the anniversary date of each line-of-credit account,
- Brokerage fees for certain loans and appraisals of real property offered as security,
- Intangible personal property tax, if secured by a loan note on real property,
- Documentary excise tax and lawful fees,
- Insurance premiums,
- Actual and reasonable attorney fees and court costs,
- Actual and commercially reasonable expenses for recovering the collateral property,
- Delinquency charges of up to $15 for each payment in default for at least 10 days, if agreed upon in writing before the charge is imposed,
- A bad check charge of up to $20.

Add-on credit insurance products for consumer finance loans must be optional (and not made a condition of the loan), and must comply with the applicable Insurance Code provisions.[6] In particular,

[1] s. 516.01(2), F.S.
[2] Ch. 2013-123, Laws of Fla. TILA is codified at 15 U.S.C. §1601 et seq.; Reg Z is at 12 C.F.R. pt. 226.
[3] s. 516.031(1), F.S.
[4] s. 516.031(2), F.S.
[5] s 516.031(3), F.S.

credit insurance insures the debtor for loss of life, involuntary unemployment, illness, or damage or loss to any collateral property. Credit insurance forms and rates must be approved by the Office and Insurance Regulation (OIR).[7] As described below, TILA and Reg Z does not include credit insurance premiums in the finance charge.

The Act provides the grounds for denial of a license of other disciplinary action by the OFR. In particular, s. 516.07(1)(k), F.S, provides that it is grounds for administrative action, for any person to pay money or anything else of value, either directly or indirectly, to any person as compensation, inducement, or reward for referring a loan applicant to a licensed consumer finance lender.

The Act does not apply to persons doing business under state or federal laws governing banks, savings banks, trust companies, building and loan associations, credit unions, or industrial loan and investment companies.[8] As of December 2014, there are 142 licensed consumer finance loan companies operating in 349 locations in Florida.[9]

The OFR also has regulatory authority over other small consumer loans authorized under ch. 520 (retail installment sellers), ch. 537 (title loans), and part IV of ch. 560 (deferred presentment or payday loans), F.S.:

- *Title lenders* provide loans secured through transfer of a motor vehicle certificate of title, with the loan amount dependent on the vehicle's value. Title lenders charge tiered interest rates according to principal amount, similar to the Act. The maturity date of a title loan is 30 days after the agreement date, but the loan can extended for one or more 30-day periods by mutual consent of the lender and the borrower.[10] One major difference between consumer finance loans and title loans is that title lenders are prohibited from selling or charging for any type of insurance in connection with a title loan.[11]
- *Retail installment lenders* under ch. 520, F.S., authorizes retail installment businesses, motor vehicle sellers, and home improvement businesses to finance personal, family, or household goods or services sold by an installment contract or a revolving charge account to a retail buyers.[12] Finance charges under ch. 520, F.S., are expressed in dollar amounts (e.g., $12 per $100 per year for retail installment contracts).[13]
- *Deferred presentment or payday lenders* under part IV of ch. 560, F.S., offer currency or a payment instrument (e.g., electronic funds transfer, check, or money order) in exchange for a person's paycheck up to $500 and agree to hold it for a specified period. Repayment terms range from 7 to 31 days, and the maximum allowable fees is 10% of the currency or payment instrument provided, as well as a verification fee of up to $5.00 per transaction. Borrowers may have only one active payday loan at a time, but are permitted to secure a new loan 24 hours after paying off the original loan.[14]

Current law does not require any underwriting or determination of the borrower's ability to repay for any of these loans. Additionally, retail installment loans and consumer finance loans are excluded from the 18 percent per year simple interest cap set forth in the usury statute.[15]

Federal Regulation of Consumer Lending

Truth in Lending Act and Regulation Z

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[6] s. 516.35, F.S.; see also pt. IX, ch. 627, F.S. (Credit Life and Disability Insurances).
[7] ss. 627.682 and 627.6785, F.S. Credit insurers must meet specified loss ratios for credit life and credit disability insurance. Rules 69O-163.009 - 69O-163.011, Fla. Admin. Code.
[8] s. 516.02(4), F.S.
[9] Office of Financial Regulation, *Fast Facts* (2nd edition, Dec. 2014), http://flofr.com/StaticPages/documents/FastFacts2015.pdf
[10] s. 537.011(3), F.S.
[11] s. 537.013(1)(h), F.S.
[12] Pts. I, II, and IV, ch. 520, F.S.
[13] s. 520.34(6)(a), F.S.
[14] s. 560.404(6) and (8), F.S.; Rule 69V-560.801, Fla. Admin. Code.
[15] s. 687.02, F.S.

The purpose of TILA and Reg Z is to promote the informed use of credit through "a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him."[16] As mentioned above, TILA and Reg Z requires the calculation and disclosure of Annual Percentage Rate (APR) for all consumer loans.[17] TILA does not include premiums for credit life, accident, or health insurance when calculating the loan's finance charge, as long as the insurance products are voluntary, the lender tells borrower in writing that these products are voluntary, and the borrower consents in writing.[18]

Consumer Financial Protection Bureau

On July 21, 2010, the federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111-203, H.R. 4173, commonly referred to as "Dodd-Frank") was signed into law. It has widely been described as the most expansive financial regulatory legislation since the 1930s, and was formed with the intent "to focus directly on consumers, rather than on bank safety and soundness or on monetary policy."[19] Title X of Dodd-Frank created the Consumer Financial Protection Bureau (CFPB) as an independent bureau housed within the Federal Reserve System, and reassigned most general rulemaking authority of TILA to the CFPB effective July 21, 2011. Dodd-Frank also:

- Assigned the CFPB broad authority to examine and enforce consumer protection regulations over all mortgage-related businesses, large non-bank financial companies, and banks and credit unions with assets greater than $10 billion. In essence, Dodd-Frank makes the CFPB the primary regulator over non-depository lenders.
- Consolidated and transferred most federal consumer financial protection authority under the CFPB's jurisdiction.[20]
- Granted enforcement and rulemaking authority to the CFPB to protect consumers from unfair, deceptive, or abusive acts or practices under federal law in connection with consumer financial products or services.[21] The CFPB is also authorized to write rules to ensure consumers receive full, accurate, and effective disclosures relating to consumer financial products and services.[22]

Additionally, Title XII of Dodd-Frank, titled "Improving Access to Mainstream Financial Institutions,"[23] which authorizes the Secretary of the Treasury to establish a multiyear program of grants, cooperative and financial agency agreements, and similar contracts to promote expanded access to mainstream financial institutions and low-cost alternatives to small dollar loans. Title XII also authorizes grants and financial assistance to help community development financial institutions to establish and maintain small dollar loan programs.[24]

Recent media reports indicate that the CFPB will soon release proposed rules on payday lending, focusing on stricter underwriting requirements (including borrowers' ability to repay), rollovers, an "off-ramp" for repaying the debt, and restricting lenders' access to a borrower's checking account. However, it is unknown what types of loans will fall within the CFPB's proposed rules, such as auto title loans and installment loans.[25] It appears that the CFPB's proposed rules will address recent loopholes in various state lending laws.[26]

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[16] 15 U.S.C. §1601(a).
[17] 15 U.S.C. §§ 1604 – 1606.
[18] 15 U.S.C. §1605(b).
[19] CONSUMER FINANCIAL PROTECTION BUREAU, *Creating the Consumer Bureau*, at http://www.consumerfinance.gov/the-bureau/creatingthebureau/ (last viewed Mar. 22, 2015).
[20] Dodd-Frank required the Secretary of the U.S. Treasury to establish a designated transfer date by which the CFPB would receive certain rulemaking, supervision, and enforcement powers from seven existing federal agencies. The Treasury Secretary established July 11, 2011, or one year after the enactment of Dodd-Frank, as the designated transfer date. *See* 75 FR 57272 (Sept. 20, 2010) and 76 FR 43569 (July 21, 2011).
[21] 12 U.S.C. §5531.
[22] 12 U.S.C. §5532.
[23] 12 U.S.C. subchapter VII. "The purpose of th[e] subchapter is to encourage initiatives for financial products and services that are appropriate and accessible for millions of American who are not fully incorporated into the financial mainstream." 12 U.S.C. § 5621.
[24] "Community development financial institutions" must be depository institutions (such banks and credit unions) which meet the definition and criteria in 12 U.S.C. §2702(5).
[25] Alan Zibel, *CFPB Sets Sights on Payday Loans*, WALL STREET JOURNAL (Jan. 4, 2015), http://www.wsj.com/articles/cfpb-sets-sights-on-payday-loans-1420410479; Jessica Silver-Greenberg, *Consumer Protection Agency Seeks Limits on Payday Lenders*, NEW

Effect of the Bill

The bill creates an alternative "consumer installment loan" within the Act to permit loans ranging between $300 and $2,000, for terms of 6-24 months. Under current law, loans in these amounts would normally be subject to the 30% interest rate. The bill provides that instead of the interest rate, the licensee lender may charge:

- A "nonrefundable processing fee" not to exceed the lesser of 10% of the amount financed or $150; and
- An "installment loan handling charge" that does not exceed:
  - $5 per $100 of the amount financed per month for installment loans between $300-$500; or
  - $4 per $100 of the amount financed per month for installment loans between $501-$2,000.

The bill does not specify when the handling charge is to be assessed (on a monthly basis) or front-loaded in a lump-sum assessment. Additionally, the bill does not specify whether the "one-time processing fee" is assessed one time as a customer or for each loan.

The bill provides that no other charges are authorized for installment loans, except for:

- Actual, reasonable attorney fees and court costs;
- A delinquency charge of up to $15 for each payment in default for 10 days or more, if the charge is agreed upon in writing between the parties at the time the loan is made; and
- A bad check charge, as allowed for consumer finance loans under current law (which is capped at $20).

Unlike the current Act, the bill appears not to allow any insurance premiums for these alternate installment loans.

According to advocates of the bill, these loans may be easier for consumers to understand due to the use of flat dollar charges, as opposed to interest rates and add-on products such as credit insurance. Additionally, some advocates state that APR is misleading as a cost of credit, because it is assumes a one-year term and accordingly distorts rate caps for smaller, shorter term loans.[27] For example, a $300 loan at 36% results in a $108 rate. On the other hand, the cost of the loan over 6 months is $120, which is only $12 more (or $2 more per month) than a 36% rate; the higher APR is due to the shorter loan term.[28]

According to APR calculations provided by various stakeholders, loans under these bills amount to a higher APR than if they were made with a 30% interest rate under current law. APRs calculated on hypothetical loan amounts and terms under current law (which would be a 30% interest rate) are set forth below:

APRs under current law:[29]

Amount of Loan	Term of Loan	APR
$300	6 months	90.407%
$300.06	12 months	77.59%

YORK TIMES (Feb.8, 2015), http://dealbook.nytimes.com/2015/02/08/consumer-protection-agency-seeks-limits-on-payday-lenders/?module=BlogPost-Title&version=Blog%20Main&contentCollection=Legal/Regulatory&action=Click&pgtype=Blogs®ion=Body&_r=0

[26] Jeff Guo, *Many states have cracked down on payday loans. Here's how lenders still get away with it*, THE WASHINGTON POST (Feb. 9, 2015), http://www.washingtonpost.com/blogs/govbeat/wp/2015/02/09/many-states-have-cracked-down-on-payday-loans-heres-how-lenders-still-get-away-with-it/

[27] Nevertheless, the prevailing and required standard for measuring and disclosing the cost of credit to consumers is the APR, as required by TILA.

[28] Background information on HB 1081 and SB 1012, on file with the Insurance & Banking Subcommittee.

[29] Florida Proposed Chart under Chapter 516, on file with the Insurance & Banking Subcommittee staff.

$500	6 months	87.3%
$500	12 months	76.097%
$1,000	12 months	71.914%
$1,500	6 months	80.341%
$2,000	12 months	72.667%

APRs under the bill:[30]

Amount of Loan	**Term of Loan**	**APR**
$300	6 months	126.624%
$300.06	12 months	111.427%
$500	6 months	126.634%
$500	12 months	111.417%
$1,000	12 months	94.208%
$1,500	6 months	108.747%
$2,000	12 months	90.542%

Rescission and Refund

The bill permits a borrower to cancel an installment loan up to 5 days after the loan is made, and requires the lender to "promptly" refund all fees and charges to the borrower. However, the bill does not provide a specific timeframe for refunds.

"Exit Ramp"

The bill provides that borrowers who repay installment loans in full with cash, a new loan, or a renewal of the existing loan at least 30 days before the date that the final installment is due, the licensee must refund or credit the unearned portion of any *loan handling charge* made in connection with the loan. The refund or credit shall be calculated according to the actuarial method from the date of the loan until the date the loan is paid in full.[31] However, the bill does not provide for the refundability of the processing fee upon early repayment.

Advocates characterize this provision as an "exit ramp" so that borrowers can avoid a cycle of debt. However, opponents note that this feature incentivizes loan churning (subsequent re-borrowing). Although the bill proposes a minimum 6-month loan term, the nonrefundability of the processing fee may encourage a series of single balloon-payment loans, whereby the lender encourages the borrower to pay off the loan early and then quickly refinance, which is not prohibited in either current law or in the bill. For example, on a $500 6-month loan, the lender may charge a $50 processing fee and a $150 handling fee (for a total of $200). If the borrower exercises the "exit ramp" option under the bill and repays the principal within one month, the lender must refund or credit $125 of the handling fee. However, because the $50 processing fee is nonrefundable, the borrower will have paid $75 for a $500 one-month loan, which effectively means a 182% APR.[32]

Credit History

While the bill does not make mention of credit reporting, advocates of the bill have stated that these alternate installment loans may help individuals with little or no credit to establish and build a good credit rating, especially as they currently may not qualify for traditional bank loans or credit cards.

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[30] Id.

[31] "Actuarial method" means that the installment lender must first apply the amount tendered to pay the loan in full to any accrued interest, with the remainder of the amount tendered applied to the unpaid principal balance of the loan.

[32] FLORIDA ALLIANCE FOR CONSUMER PROTECTION, *White Paper on SB 1012 & HB 1081* (Mar. 8, 2015), on file with the Insurance & Banking Subcommittee staff.

However, the federal Fair Credit Reporting Act only governs the permissible use and reporting of consumers' credit information.[33] It does not require creditors to report consumers' information to credit reporting agencies (TransUnion, Experian, and Equifax). However, if a creditor does report, FCRA requires that the information be complete and accurate. FCRA gives remedies to contest inaccurate information, which is particularly important to detect identify theft or if an application for credit has been denied based on inaccurate information.

Referral Fees

Section 2 of the bill amends s. 516.07(1)(k), F.S., to permit a licensed consumer finance lender to pay money or anything else of value, directly or indirectly, to any person as compensation, inducement, or reward for referring loan applicants to a licensee, only if such amount is not charged directly or indirectly to the borrower. This would apply to both consumer finance loans as well as the alternative consumer installment loans.

B. SECTION DIRECTORY:

Section 1. Amends s. 516.031, F.S., relating to finance charge; maximum rates.

Section 2. Amends s. 516.07, F.S., relating to grounds for denial of license or for disciplinary action.

Section 3. Provides an effective date of July 1, 2015.

II. FISCAL ANALYSIS & ECONOMIC IMPACT STATEMENT

A. FISCAL IMPACT ON STATE GOVERNMENT:

1. Revenues:

   OFR reported that the bill does not have an impact on state revenues.[34]

2. Expenditures:

   OFR reported that the bill does not have an impact on state expenditures.[35]

B. FISCAL IMPACT ON LOCAL GOVERNMENTS:

1. Revenues:

   None.

2. Expenditures:

   None.

C. DIRECT ECONOMIC IMPACT ON PRIVATE SECTOR:

Indeterminate. While the bill's alternative loan product may increase credit options for some borrowers, the rates of default and subsequent borrowing cannot be projected.

D. FISCAL COMMENTS:

None.

[33] 15 U.S.C. §§ 1681 et seq.
[34] Office of Financial Regulation, Agency Analysis of House Bill 1081.
[35] *Id.*

III. COMMENTS

A. CONSTITUTIONAL ISSUES:

1. Applicability of Municipality/County Mandates Provision:

Not applicable. This bill does not appear to: require counties or municipalities to spend funds or take an action requiring the expenditure of funds; reduce the authority that counties or municipalities have to raise revenues in the aggregate; or reduce the percentage of a state tax shared with counties or municipalities.

2. Other:

None.

B. RULE-MAKING AUTHORITY:

None provided by the bill.

C. DRAFTING ISSUES OR OTHER COMMENTS:

- The bill does not define "consumer installment loan."
- The bill does not specify when the handling charge is to be assessed (on a monthly basis) or front-loaded in a lump-sum assessment. Additionally, the bill does not specify whether the "one-time processing fee" is assessed one time as a customer or for each loan.
- The bill permits a borrower to cancel an installment loan up to 5 days after the loan is made, and requires the lender to "promptly" refund all fees and charges to the borrower. However, the bill does not provide a specific timeframe for refunds.

IV. AMENDMENTS/ COMMITTEE SUBSTITUTE CHANGES