September 2014

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Legislative Committee Services
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Background Brief on …

Short-Term Loans

History

With various restrictions lifted on the financial services industry nationwide beginning in the 1980s, non-bank financial service providers began offering short-term loans and check cashing services to take advantage of the ability to charge triple-digit interest rates. Banks and credit unions also offered customers emergency, short-term loans in the form of overdraft protections, direct deposit advances, and checking account advance loans. Although these emergency, short-term loan services are available only to bank and credit union customers, they contain the same features as a payday or title loan – high interest rates and short repayment periods – with the additional benefits of direct access to a customer's checking account for repayment and the ability to collect late fees.

When a growing number of American households were living paycheck to paycheck, consumers turned to short-term credit and loans to meet their financial needs, despite the fact that these types of loans had annual interest rates over 300 percent with some annual percentage rates as high as 782 percent. According to studies conducted by the Consumer Financial Protection Bureau and the Center for Responsible Lending, the average consumer of non-bank payday loans takes out nine loans annually and remains in debt for 212 days during the first year. One of the largest national car-title lenders reported that its average customer renews their loan eight times. Because short-term loans are typically renewed at the end of each period without a reduction in principal, the loans generate significant fees for lenders while increasing the financial burdens for consumers who cannot afford to pay the entire balance of the loans when due.

To prevent the payday lending industry from exploiting the financial struggles of Oregonians, legislation was enacted in 2000 requiring non-bank financial service providers offering short-term credit and loans to Oregon consumers to be licensed by the state. Caps on the amount of interest and fees that these lenders could charge were adopted in 2006. Banks and credits unions, however, are not subject to the caps.

Payday Loans Made by Non-bank Financial Service Providers

A payday loan offered by a non-bank financial service provider is a cash loan of up to $50,000 with short terms (less than 60 days but at least 31 days) made to a borrower with regular income evidenced by a paycheck stub. Oregon law prohibits a non-bank payday lender from making or renewing a loan at an interest rate that exceeds 36 percent annum. The lender may charge a one-time loan origination fee of $10 per $100 of the loan amount, not to exceed $30. No additional fees or interest charges are allowed. A payday loan can be renewed only twice, and a new payday loan must not be made until seven days after expiration of the previous loan.

Oregon law requires non-bank payday lenders to obtain a license from the Department of Consumer and Business Services **(DCBS)**. The law also requires specific disclosures to borrowers, including the level of interest calculated on an annual percentage rate basis. The agency's regulatory framework includes an initial review of a license applicant's qualifications, annual reporting by the licensee, periodic examination of records at the licensee's place of business, and special investigations when necessary. Administrative sanctions for violations of the law include license suspensions or revocations, cease-and-desist orders, and civil penalties.

Oregon is one of 38 states that regulate non-bank payday lenders. In 2006, Congress passed legislation capping non-bank payday loans at 36 percent annum for active duty military personnel and their families. Several Oregon cities, including Portland, Eugene, Gresham, Oregon City, Beaverton, Bend, and Silverton, have adopted ordinances requiring 25 percent payment on principal before loan renewal, as well as installment repayment plans. Oregon law does not require any principal payment prior to renewing a payday loan.

Payday Loans Made by Banks and Credit Unions

The most dramatic growth in bank and credit union short-term lending activity has been the fees collected as part of overdraft protection programs. Before the expansion of automated overdraft programs, banks and credit unions provided their customers with courtesy overdraft protection. Now, however, banks and credit unions routinely charge fees to cover overdrafts. Because of recent restrictions on overdraft fees, banks and credit unions have begun promoting other payday loan services, including direct deposit or checking account advances. Bank and credit union payday loans are not subject to state law limiting interest and fees charged by non-bank payday lenders. For this reason, some non-bank payday lenders have partnered with banks who issue prepaid debit cards to the borrower instead of cash. This allows non-bank payday lenders to offer high-interest payday loans despite state laws capping rates at 36 percent.

In 2005, the Federal Deposit Insurance Corporation issued guidelines to state-chartered banks instructing them to limit the length of time banks should allow payday loan indebtedness. Likewise, the National Credit Union Administration is being asked to stop federal and state credit unions from investing in, taking finder's fees from, or otherwise engaging with credit union service organizations that are involved with payday lending activities that would otherwise be unlawful or would pose undue safety and reputation risks if the credit union made those loans directly.

Bank and credit union payday loans contain many of the same features – triple-digit interest rates, balloon payments, and a short repayment period – that prompted state legislation aimed at regulating non-bank payday lenders. The typical bank payday loan carries an annual percentage rate of 365 percent based on a loan term of ten days. A short-term bank payday loan can lead to a cycle of long-term indebtedness; on average, a bank payday borrower is in debt 175 days of the year– twice as long as the FDIC guidelines recommend. For consumers with direct deposit of their paycheck or Social Security or other public benefit check, banks and credit unions may be willing to advance up to half of the next deposit with immediate access to those funds as soon as the deposit is made.

Title Loans

Title loans are secured by the title to the borrower's motor vehicle, boat, recreational vehicle, or mobile home. Most title lenders are also licensed as payday lenders or conventional lenders and are regulated by DCBS with requirements for disclosure and business practices similar to payday lenders.

Title lenders are limited to charging no more than an annual rate of 36 percent, and are allowed a maximum one-time origination fee of $10 per $100 of the loan amount up to $30.

Title loans cannot exceed $50,000 and are limited to a minimum term of 31 days and maximum 60 days. A lender may renew a title loan twice. Lenders are prohibited from making a new loan within seven days of the expiration of the previous title loan. Licensees must also participate in the DCBS database that tracks payday and title loan lenders.

Check Cashing Services

As of 2008, check cashing businesses must be licensed by DCBS and must follow statutory limits on fees that can be imposed on their services. Fees for checks issued by federal, state, or local governments may be up to $5 or 2 percent of the face value of the check, whichever is greater; fees for checks from out-of-state government entities are limited to $5 or 3 percent of the face value of the check, whichever is greater; and fees for other payment instruments may be up to $5 or 10 percent of the payment instrument, whichever is greater. In all cases, fees are limited to $100.

Money transmitters operating under a valid Oregon license do not have to be licensed. However, licensed money transmitters do have to comply with the limits on fees charged, fee posting requirements, record keeping, and other requirements of the law.

Pawnbrokers

Pawnbrokers make loans secured by personal property. Pawnbrokers are licensed and regulated by DCBS. The interest and fees they charge are capped at a set-up fee of 10 percent with a $100 maximum plus three percent per month interest. Unless stated otherwise on the pawn ticket, loans are for 60 days. Loans may be renewed for 60 days or longer. A pledge is forfeited if not redeemed within 30 days after the pawnbroker mails a notice.

Conventional Small Loans

Finance companies make loans of up to $50,000 for a loan term of more than 60 days. Most conventional consumer finance companies are national, and many are associated with nationally chartered banks.

The annual percentage rate on a consumer finance loan is limited to 30 percent above the Federal Reserve discount rate or 36 percent, whichever is greater, and lenders can charge a one-time origination fee of $10 per $100 of the loan's amount.

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