HOUSE RESEARCH ORGANIZATION bill analysis | 5/10/2001 | HB 690 Thompson (CSHB 690 by Solomons)

SUBJECT: Interest on loans not secured by real property

COMMITTEE: Financial Institutions — committee substitute recommended

VOTE: 7 ayes — Averitt, Solomons, Denny, Grusendorf, Hopson, Menendez, Wise

0 nays

2 absent — Marchant, Pitts

WITNESSES: For — George W. Berry and Joe Leal, Jr., Texas Financial Services Association; Robert Power, Washington Mutual Finance; *Registered but did not testify:* Ken Scruggs, Household Financial Group

Against — Rob Schneider

On — Leslie Pettijohn, Office of the Consumer Credit Commissioner

BACKGROUND: Finance Code, chapter 342 regulates consumer loans. Sec. 342.201 sets the maximum interest rates that lenders can charge on loans that are not secured by real property. Sec. 342.351 provides the rule (known as the Rule of 78s) for calculating refunds from the lender to the borrower on a regular loan contract with precomputed interest. Sec. 342.352 defines and allows certain lenders to use a method of calculating interest on a loan called the scheduled installment earnings method. Sec. 342.002(a) defines this method as a method of computing an interest charge by applying a daily rate to the unpaid balance of the principal as if each payment will be made on its scheduled installment date.

DIGEST: CSHB 690 would raise the maximum interest rate from 18 percent to 30 percent on the part of a loan amount that is $6,000 or less. The maximum rate for the part of a loan amount over $6,000 but less than $12,000 would be 24 percent. The loan amounts would be indexed to the Consumer Price Index so that the amount borrowed that could be charged at these higher rates would rise with inflation. A lender could extend only one of these higher-interest loans to a person or a married couple at any one time, and the term of the loan would be limited to 37 to 60 months, depending on the loan amount.

The bill would amend Finance Code, sec. 342.351 so that the rule of 78s would not apply to loans under sec. 342.201 for which the bill would allow 24 and 30 percent interest. Lenders under sec. 342.201 could use the scheduled installment earnings method under sec. 342.352. The bill also would delete the definition of the installment method in section 342.352(f) and refer to it simply as the scheduled installment earnings method.

The bill would take effect September 1, 2001.

SUPPORTERS SAY:

The higher interest rates that CSHB 690 would authorize are necessary for many loans because these lenders' risk and expenses have made it unprofitable for them to make loans in Texas. However, the bill would balance the need for higher effective interest rates on smaller loans, since expenses tend to be fixed regardless of the principal amount, by setting a lower 24 percent ceiling on interest charged on loans between $6,000 and $12,000. Also, by eliminating the rule of 78s, which front-loads interest and penalizes those who either pay the loan off early or refinance the loan, the bill would reduce the costs of borrowing.

CSHB 690 would ensure that lenders will continue to locate and make loans in Texas. Because some states have much higher (or no) maximum rates, and because federal law allows lenders to have storefronts to take applications in one state but to originate their loans in another state, many lenders have relocated out of Texas and no longer are regulated by Texas' consumer credit commissioner, even though they are making loans to Texans.

OPPONENTS SAY:

CSHB 690 would increase consumers' cost of borrowing money at a time when interest rates for these loans are already fairly high. For instance, the current effective interest rate for a $3,000 loan is almost 23 percent once fees are considered. Under this bill, at a flat 30 percent rate, the consumer would pay about $257 more in interest. According to one estimate, this bill would cost consumers $87 million.

NOTES:

The committee substitute added the two-tiered interest rate and would eliminate the rule of 78s for all of these loans, whereas the filed version would have given the lender a choice between higher interest and no rule of

78s or lower interest with the rule.

The companion bill, SB 272 by Carona, which would set lower limits on the loan amounts, passed the Senate on April 2 by voice vote and was reported favorably, without amendment, by the House Financial Institutions Committee on April 26, making it eligible to be considered in lieu of HB 690.