

BILL ANALYSIS

Senate Research Center
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S.B. 251
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Many payday lenders and auto title lenders in Texas are engaging in predatory lending practices that trap unwary consumers in a vicious cycle of debt by charging interest rates of over 500 percent.

S.B. 317, 77th Legislature, Regular Session, 2001, was enacted to regulate such sharp business practices by directing the Texas Finance Commission to adopt rules regulating deferred presentment transactions, commonly referred to as "payday loans." These rules, found in Title 7, Rule 83.604 (Payday Loans; Deferred Presentment Transactions), Administrative Code, limit the interest and fees that may be charged for such loans. These rules also provide that payday lenders must allow consumers to pay off the principal over time (a "declining balance installment note") rather than continuing to charge consumers additional fees to renew their loan if they cannot pay off the balance in full at the end of the term (a "single payment balloon loan") which effectively prevents consumers from making a dent in the principal even as they incur renewal fees to roll over the loan an average of six to nine times before it is paid off.

However, a loophole still exists that allows third parties known as Credit Services Organizations (CSO) to obtain loans for consumers and charge fees that exceed what lenders themselves could charge under Texas usury law. The Fifth Circuit Court of Appeals confirmed the existence of this loophole in *Lovick v. Ritemoney Ltd.*, 378 F.3d 433 (5th Cir. Court of Appeals 2004). Since *Lovick*, the number of CSOs operating in this state has nearly tripled (from 1,279 in 2006 to 3,594 by 2010), and now approximately 95 percent of all payday loans are made outside the regulatory framework designed to protect consumers against predatory lending.

The CSO loophole needs to be closed so that the consumer protection laws already in place will also apply to payday and auto title lenders. Specifically, S.B. 251 amends Sections 393.001(3)(B) and (C), Finance Code, to prohibit CSOs from obtaining loans for consumers, and would add Section 302.003, Finance Code, to provide that the fees charged by any other third party to obtain a payday loan or auto title loan for a consumer will be deemed interest for usury purposes.

As proposed, S.B. 251 amends current law relating to the regulation of activities with respect to certain extensions of consumer credit.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Subchapter A, Chapter 302, Finance Code, by adding Section 302.003, as follows:

Sec. 302.003. PROHIBITION ON THIRD-PARTY FEES TO ARRANGE OR GUARANTEE CERTAIN EXTENSIONS OF CONSUMER CREDIT. (a) Prohibits a fee paid or to be paid to a third party to assist a consumer in the transacting, arranging, guaranteeing, or negotiating of an extension of credit from being contracted for, charged,

or received by a creditor or third party in connection with the extension of credit if the extension of credit is secured by a non-purchase money security interest in personal property or is unsecured and the proceeds of the extension of credit are used for personal, family, or household purposes.

(b) Provides that the amount of a fee contracted for, charged, or received in violation of Subsection (a) is considered interest for usury purposes under state law.

SECTION 2. Amends Section 393.001(3), Finance Code, to redefine "credit services organization."

SECTION 3. Amends Subchapter D, Chapter 393, Finance Code, by adding Section 393.308, as follows:

Sec. 393.308. OBTAINING EXTENSIONS OF CONSUMER CREDIT PROHIBITED. Prohibits a credit services organization from obtaining an extension of consumer credit for a consumer or assisting a consumer in obtaining an extension of consumer credit.

SECTION 4. Effective date: September 1, 2011.