Senate Bill 515

Reforming Payday Loans

Senator Jackson

Summary

Payday loans are small, short-term loans that are marketed as a quick and easy way to bridge the financial gap until the borrower's next payday. For California families living paycheck to paycheck, the high price of a payday loan and that it must be paid off in one lump sum after only two weeks, virtually ensures that cash-strapped borrowers will be unable to repay their loan and have enough left over to meet their other basic expenses. As a result, California borrowers get caught in a cycle of repeat borrowing of 459% Annual Percentage Rate (APR) loans.

Reforms are necessary to ensure that payday loans serve their advertised purpose and better protect consumers.

Background

Payday loans work like this: a borrower writes a check to the payday lender for the loan amount plus interest, and either the borrower repays the loan directly or the lender can deposit the check on the borrower's next payday. In California, a consumer can borrow up to $255. For a $255 loan, the borrower writes a $300 check ($255 loan plus $45 interest) that will be typically due about 2 weeks later. This computes to an annual interest rate of 459%. All that is required for a loan is a checking account and proof of income from work or public benefits, including Social Security or unemployment insurance.

By virtue of this process, almost all California borrowers are forced to pay off one loan and immediately take out a new loan, repeating the cycle over and over, creating an expensive "debt trap." Research shows that 75% of payday loan volume is generated by "churning", i.e., by borrowers who, after repaying the loan, must re-borrow before their next pay period to make ends meet. Although payday loans are marketed and publicly rationalized as a short-term loan for occasional, unexpected expenses, research shows that the business model is designed to keep borrowers coming back for more payday loans. Far too often, driven by necessity and desperation, they do.

The California Department of Corporations (DoC) has acknowledged, "[W]hen payday loans are used for a long period of time, the fees charged can rapidly exceed the amount borrowed and can create a serious financial hardship for the borrower." Adopting a loan limit would prevent payday loans from being used as a long-term source of extremely high cost credit.

Solution

SB 515 proposes a series of reforms to allow payday loans to better serve their advertised purpose while making the loans safer for consumers. It would:

- **Establish an Annual Loan Limit Per Borrower to Prevent Repeat Borrowing:** By limiting the number of payday loans payday lenders can make to a borrower to 4 per year, SB 515 allows borrowers to continue to utilize emergency high-cost credit. To ensure compliance across all lenders in the state, the loan limit would be enforced by a database created and overseen by the Department of Corporations. This reform would maintain the current fee structure for payday loans.
- **Extend Minimum Loan Terms to Give Borrowers More Time to Repay Their Loans:** SB 515 increases the amount of time a borrower has to pay back a loan to 30 days per $100. Currently payday loans are due in full typically in about 2 weeks, when research shows that most borrowers cannot meet other basic financial obligations without re-borrowing.
- **Establish Reasonable Requirements for Lenders to Assess Borrowers' Ability to Repay Their Loans:** SB 515 proposes standards established in the 2010 CFLL small dollar loan pilot program (SB 1146, Florez) to ensure that both income and debt obligations are verified and considered before a loan can be made.

Additional Proposed Changes in SB 515 would:

- Allows a borrower who is unable to repay a payday loan in full on the due date to enter into an installment repayment plan.
- Requires payday lenders to provide additional information to the Department of Corporations for the annual report on the deferred deposit transaction law.

Support

Sponsor: Center for Responsible Lending

- Support available upon request.

Status

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