Policy Brief: What Happened with Payday Loans in Ohio?

Diane Standaert, Director of State Policy August 2018

In 2008, the majority of Ohio voters affirmed capping the cost of payday loans in the state to 28% interest, inclusive of all fees and other charges. Since that time, payday and car title lenders have evaded the voter-mandated cap, engaging in schemes to charge rates reaching over 300% annual percentage rate (APR), and even higher than 500% APR. In 2018, after a decade of inaction by Ohio regulators and lawmakers, the Ohio legislature approved some restrictions on these lending schemes.

Even with these 2018 changes, payday lenders in Ohio will still be able to charge upwards of 200% APR, and still will not be subject to requirements that ensure the loans can be repaid without reborrowing or defaulting on other expenses. This policy brief provides a summary of Ohio's payday loan laws following the changes enacted in 2018 and highlights remaining consumer concerns.

There are four statutes that govern various types of small dollar consumer lending in Ohio: the Short Term Loan Act, the Small Dollar Loan Act, the Second Mortgage Loan Act, and the Consumer Installment Loan Act. The Ohio Credit Services Organization (CSO) Act has also been exploited by payday lenders and car title lenders to engage in brokering schemes to make loans outside of the voter-affirmed rate cap.

This brief focuses primarily on the changes to the Ohio Short Term Loan Act and the CSO Act but also highlights some of the other types of lending still permitted under the other statutory regimes.

Ohio Short Term Loan Act

In 2008, voters affirmed a 28% rate cap, inclusive of all fees and charges, for payday loans in the Ohio Short Term Loan Act, with which the payday lenders have never complied.[1]

The 2018 law changes increase the fees permitted under the Short Term Loan Act, resulting in rates of up to 200% APR for some payday loans made under this section.[2] Additionally, payday lenders will be able to take access to a borrower's bank account through post-dated checks or electronic debit authorization, with no requirements that the loan be affordable in light of a borrower's income and expenses. The law does not provide any protections against back-to-back loans, and it allows borrowers to have $2,500 in outstanding payday loans from multiple lenders at a single time.[3]

The Ohio Short Term Loan Act now provides for a maximum loan size of $1,000 and a maximum loan term of 12 months. With the recent changes, payday loans under the Act can include three charges which combine to result in triple-digit APRs, as shown below:

- 28% annual interest;
- monthly maintenance fees totaling $30 or 10% of the loan amount, whichever is less; and
- an origination fee of 2% for loans larger than $500.[4]

Figure 1: Example APRs under Ohio Short Term Loan Act.			
Loan Size	**Term**	**Total Charges**	**APR**
$200	1 month	$24.67	150%
$300	5 months	$171	206%
$500	6 months	$230.81	144%
$500	12 months	$300	97%
$1,000	12 months	$531.60	87%

In addition to the charges detailed above, the law now permits payday lenders to charge a $10 fee for cashing the check on which the loan proceeds are disbursed.[5] This $10 check cashing fee is not included in APR calculations, per the federal Truth in Lending Act, but nonetheless increases the cost to borrowers of taking out a loan. Payday loans are prohibited from carrying fees related to ancillary products. If the loan is repaid early, the interest and fees are pro-rata refundable—a protection that lessens, but does not eliminate, the incentive to flip loans. [6]

Two other provisions are aimed at curbing the harms of the payday loan debt trap but none of these provisions address the high costs highlighted in Figure 1, nor serve as substitutes to an affordability test that ensures a borrower can repay the loan without defaulting on other expenses or needing to reborrow.

- **Income-test provisions**: Under the amended Ohio Short Term Loan Act, for loans with terms of less than 90 days, monthly loan payments cannot exceed 6% of a borrower's gross monthly income, or 7% of net monthly income.[7] This income-test provision primarily functions to move payday lenders away from making short term, balloon payment loans.[8] For loans over 90 days, the payments are not required to meet these thresholds, rather there is simply a requirement that lenders show what a repayment schedule under the 6%- and 7%-of-income thresholds would look like.[9] Even if mandatory, an income-only test alone is insufficient to ensure affordability as it fails to account for a borrower's existing obligations, such as rent, child care, student loan debt, or even other payday loan payments.[10]

- **Maximum total fees as portion of amount borrowed:** Under the amended law, payday lenders can still charge fees that reach up to 60% of the amount borrowed.[11] This provision primarily works to reduce some of the fees that would otherwise be paid on larger payday loans with longer terms. For a broad swath of loans, however, particularly those under five months, the 60% limit does not result in a reduction of fees that could otherwise be charged.[12] For example, the $300, five-month loan, with 206% APR as shown in Figure 1 does not reach the 60% threshold.

Credit Services Organization Loophole

Prior to the 2018 law changes, and in evasion of the 2008 voter-affirmed rate cap, payday and car title lenders exploited the state's Credit Services Organization (CSO) Act to make loans at rates over 10 times

the 28% rate cap. Significantly, car title loans are not explicitly authorized in Ohio – they entered the market in 2012 through schemes such as under the CSO Act.[13] The making of predatory loans through the CSO Act is a perversion of the act's actual intent — to protect against credit repair scams.[14]

Making loans through the CSO loophole requires an ostensible three-party relationship – the borrower; the payday lenders operating as the CSO or broker, for which the borrower pays a fee; and a funder providing the funding for the loan at a 28% interest rate. Combined, the unlimited CSO fees plus the 28% interest resulted in triple-digit APR payday and car title loans, trapping borrowers in a cycle of debt. Prior to the 2018 law change, Ohio's Attorney General could have taken action to halt this subterfuge scheme as other states have done, but it did not. Likewise, the legislature could have acted, as other states have done, but it did not.

The 2018 legislative changes made some strides in closing this loophole. The Ohio Credit Services Organization Act now prohibits extensions of credit less than $5,000, less than one year in length, or in excess of 28% APR, as APR is defined under the federal Truth in Lending Act (TILA). This change likely addresses the bulk of the abusive payday and car title loans offered through this scheme, but additional monitoring and enforcement will be key to its effectiveness. The Truth in Lending Act APR does not include costs for application or participation fees; the costs of "voluntary" ancillary products like credit insurance; nor any of the fees on open-end lines of credit. While the loophole is largely closed due to prohibitions related to the size and the terms of the loan, it will be important to monitor the market changes as it relates to loans that include those fees not covered by the TILA APR—application or participation fees, ancillary products, and fees on open-end loans—given that each of these are areas high-cost lenders have exploited in other states.[15]

Other Statutes for Small Dollar Lending in Ohio

There are other areas of law in Ohio in which small dollar or consumer lending may occur. These include the Ohio Small Dollar Loan Act, the Second Mortgage Loan Act, and the Ohio Consumer Installment Loan Act. Among the 2018 law changes, under both the Ohio Small Loan Act and the Ohio Second Mortgage Loan Act, lenders are now prohibited from making loans of $1,000 or less or with terms of one year or less, thus seeking to move the bulk of this market to the Ohio Short Term Loan Act discussed above. However, no similar prohibition exists for the Ohio Consumer Installment Loan Act. Under the Consumer Installment Loan Act, an open-end line of credit under $5,000 can carry 28% interest, a $150 application fee, and a $25 credit investigation fee.[16] For a $500 line of credit, this is an effective 144% APR, and for a $300 line of credit it would be a 215% APR.[17]

Lessons from Colorado

Colorado enacted reforms in 2010 similar to, and more restrictive than, what the Ohio law will now allow. Colorado data provide a helpful guide to the impact on consumers, and it will be important to monitor and assess similar data points in Ohio as the law changes take effect. In Colorado, payday loans may reach up to 214% APR, and the typical loan carries a 129% APR.[18] The most recent data show that in Colorado, one in four payday loans defaults.[19] In a recent CRL report on focus groups with Colorado payday loan borrowers in 2017 – seven years following the reform – borrowers report experiencing financial distress related to the payday loans.[20]

For example, Colorado borrowers described difficulty paying bills and faced aggressive debt collection. Many had taken multiple loans from various lenders at the same time or were also struggling with other significant obligations such as student loans, medical debt, or other basic living expenses. The findings show that the lenders do not ensure whether a customer can afford to repay the loan while covering existing debts and other expenses.

The experiences in Colorado thus underscore the importance of the swift, accurate, and transparent implementation of the data reporting requirements in Ohio's law, and a willingness among policymakers to utilize that data to make additional substantial requirements to move Ohio to a regime that fully protects consumers from the harms of predatory lending.

Conclusion

While an improvement to the wild, wild west market that existed in Ohio from 2008 to 2018 as payday and car title lenders cheated their way around the voter-affirmed 28% all-inclusive rate cap, Ohio's law changes still leave borrowers exposed to high-cost loans with little assurance of affordability. Though it is likely that the market will see some reduction of storefronts and lenders, consumer exposure to harm will still be far too great. In addition to the loans' high costs, the law will still permit a high number of loans at the same time and no meaningful limits on back-to-back loans. Experiences from other states, such as Colorado, reveal that payday loans even when structured as longer-term installment loans, still cause financial harm to borrowers when made with high costs, no regards to affordability, and insufficient protections against the debt trap.

The most effective reform for states to protect against the debt trap and subterfuge is to enact and enforce exactly what the Ohio voters mandated in 2008 – a rate cap of less than 36% annually. Today 15 states plus the District of Columbia enforce rate caps of 36% APR or less. Collectively, those states save their residents over $2.2 billion annually in payday loan fees.[21] Similarly, the Military Lending Act, a bipartisan act of Congress upon recommendation of the U.S. Department of Defense, establishes a rate cap of 36% inclusive of all fees and charges for credit to military families.[22] This military rate cap reaches payday loans, car title loans, installment loans, and other consumer credit. With a strong rate cap in place, states have the ability to protect against illegal subterfuge schemes and ensure the most effective protection for their residents against the harms of predatory small dollar loans.

[1] Policy Matters Ohio, "New Law, Same Old Loans: Payday Lenders Sidestep New Ohio Law," 2009, https://bit.ly/2BggO1z
[2] Ohio Short Term Loan Act, Ohio Rev. Code Section 1321.35 to 1321.48, as amended by Ohio HB 123 (2018)
[3] Ohio Rev. Code Section 1321.41(R)
[4] Ohio Rev. Code Section 1321.40 (A), (B). For table of estimated maximum costs of loans under the Ohio Short Term Loan Act, see analysis by Ohio Legislature Senate Majority Staff, "Estimated maximum cost of loans under Sub. H.B. 123," available at https://bit.ly/2OH5IES
[5] Ohio Rev. Code Section 1321.400 (E)
[6] Ohio Rev. Code Section 1321.402
[7] Ohio Rev. Code Section 1321.39 (B)(2)
[8] Ohio Rev. Code Section 1321.39 (D)
[9] Ohio Rev. Code Section 1321.391
[10] For more analysis on why even a limit on loan payment size of 5% of income will not ensure affordable loans and prevent borrower harm, see Stop the Debt Trap, "CFPB's Proposed Payday Rule Is Better Without Loophole Based Solely on a Borrower's Income," available at https://bit.ly/2L2O3oG
[11] In addition, this 60% threshold does not include check collection charge nor the $10 fee that payday lenders can charge their own consumers for cashing the check on which the lender distributed the loan proceeds. Ohio Rev. Code Section 1321.403
[12] See e.g., table of estimated maximum costs of loans under the Ohio Short Term Loan Act, see analysis by Ohio Legislature Senate Majority Staff, "Estimated maximum cost of loans under Sub. H.B. 123," available at https://bit.ly/2OH5IES
[13] Policy Matters Ohio, "Keys for Collateral: How auto-title loans have become another vehicle for payday lending in Ohio," 2012, https://bit.ly/2MRPQyK
[14] Center for Responsible Lending, "Payday Lenders Pose as Brokers to Evade Interest Rate Caps," 2010, https://bit.ly/2Mqj6zJ
[15] See e.g., Pennsylvania Department of Banking V. NCAS Of Delaware LLC (enforcement action against payday lender Advance America for subverting the state's usury law by charging a $149 "monthly participation fee" and 5.98% interest on a $500 line of credit); and ProPublica, "Insta-Loophole: In Florida, High-Cost Lender Skirts the Law," 2013 (describing lending scheme by TitleMax in when the car title lender makes loans under the state's consumer installment loan act with interest of 30% APR per TILA and adds significant additional fees in the form of credit insurance products), available at https://bit.ly/2BerZaY; and Maryland Consumer Rights Coalition; "SB 527 Shut Payday Lender Loophole: Usury Cap Quick Fix," 2016 (describing loophole closed by the state of Maryland to stop payday lenders from making open-end loans with a 24% interest rate and hundreds of dollars in fees designed to evade the state's usury limit), available at https://bit.ly/2Mj3DSx
[16] 1321.681(E)(1)
[17] Analysis of effective APRs under the Ohio Consumer Installment Loan Act provided by Carolyn Carter, Deputy Director, National Consumer Law Center.
[18] State of Colorado, Department of Law, 2016 Deferred Deposit/Payday Lenders Annual Report, https://bit.ly/2PeTkwM.
[19] Id.
[20] Center for Responsible Lending, "Sinking Feeling: Colorado Borrowers Describe their Experiences with Payday Loans," 2018, https://bit.ly/2w5Mb9k
[21] Center for Responsible Lending, "Shark-Free Waters: States are Better Off without Payday Lending," 2017, https://bit.ly/2jn9KlH
[22] 80 FR 43560 (July 22, 2015).