HOUSE RESEARCH ORGANIZATION bill analysis 5/14/2001

SB 272
Carona
(Thompson)

SUBJECT: Interest on loans not secured by real property

COMMITTEE: Financial Institutions — favorable, without amendment

VOTE: 5 ayes — Averitt, Solomons, Denny, Hopson, Marchant

0 nays

1 present not voting — Menendez

3 absent — Grusendorf, Pitts, Wise

SENATE VOTE: On final passage, April 2 — voice vote (Barrientos, Bernsen, Nelson, Truan recorded nay)

WITNESSES: For — Ken Scruggs, Household Financial Group Ltd.

Against — Rob Schneider, Consumers Union—Southwest Regional Office

On — Leslie Pettijohn, 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 when the loan is paid off early or refinanced. 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: SB 272 would raise the maximum interest rate from 18 percent to 30 percent on the part of a loan amount that is $4,800 or less. The maximum rate for the part of a loan amount over $4,800 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.

SB 272 also would require that the Finance Commission direct the consumer credit commissioner to establish a research program to study, report on the problem of, and evaluate alternatives to high-cost consumer lending. The program would develop models to provide lower-cost alternatives to assist borrowers and could fund pilot programs and make grants to nonprofit institutions for the purpose of developing such alternatives. The program would also track where high-interest loans originate geographically and report on any changes in their distribution over time. The commissioner, instead of the Finance Commission, would be required to submit a yearly report by December 1 regarding this program and make findings and recommendations. A dollar, instead of fifty cents, of the administrative fee charged for these loans would be paid to the Comptroller's Office for use by the Finance Commission to pay the commissioner's office for undertaking these research tasks.

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 $4,800 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.

Through the studies and programs that it would direct the Office of the Consumer Credit Commissioner to undertake, the bill would seek solutions to the high costs of borrowing by focusing on alternatives can work. In a national credit market that the Texas Legislature cannot regulate, imposing artificial price ceilings no longer works. The only way to affect interest rates is to make the industry more competitive, which this bill seeks to do.

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 companion bill, HB 690 by Thompson, which would have set higher limits on the loan amounts and did not include the research provisions, was set on the House General State Calendar for May 10. SB 272 was laid out in lieu of HB 690, then postponed until today.