Consumer Law

By Lorray S.C. Brown

Has Michigan Legalized Usury?

A NEW LAW GIVES PAYDAY LENDING THE STAMP OF APPROVAL

In a showdown over what are popularly known as "payday loans," Michigan's consumer advocates lost their longstanding battle to protect low-income consumers from triple-digit interest rates and a "trap" that condemns them to perpetual indebtedness to lenders whose practices are in many ways comparable to those of loan sharks.

Payday loans, also known as "deferred presentment transactions," "cash advances," or "check loans," are small, short-term, high-rate loans that require the borrower to give the lender a postdated personal check to ensure repayment at a future date. Typically, payment is made from the borrower's next paycheck. The lender, in turn, charges a fee (interest) in exchange for the loan.

For several years, Michigan's consumer advocates were successful in holding at bay any sort of safe harbor legislation for payday lenders. Then, on November 28, 2005, Michigan enacted its Deferred Presentment Service Transactions Act.[1] The act, effective June 1, 2006, allows payday lenders to issue short-term loans to be repaid when the borrowers receive their paychecks. The catch is that the borrower must pay a fee that translates into triple-digit interest rates. Michigan has now joined 35 other states and the District of Columbia where payday lending is specifically authorized by statutes or regulations.[2] This article will: (1) describe the payday lending practices, (2) set out the arguments that fueled the debate in Michigan as to whether the payday lenders were covered by existing Michigan usury laws, and (3) discuss key components of the Deferred Presentment Service Transactions Act.

Payday lending is not a new practice. The practice of extending cash for a fee with repayment from the borrower's next paycheck is traceable to "wage assignment" and "salary buying" practices from the early twentieth century.[3] These practices were

usually a method of evading the usury laws, allowing lenders to charge exorbitant interest rates for short-term loans. The payday lending practices of today are no different from "loan sharking" practices of the past.

Generally, payday loans carry triple-digit interest rates that far surpass the limits set by usury laws. For example, a consumer who wishes to borrow $100 will be charged $15 for a two-week loan. The consumer therefore writes a post-dated check for $115 and receives $100 in cash. The actual cost of this two-week loan is $15, which is equivalent to an annual percentage rate of 390 percent. If the consumer cannot afford to repay the loan in full, the consumer may extend the loan for another two weeks by paying the $15 fee once again. This extension is generally referred to as a "rollover." If the consumer rolls the loan over three times, it will cost him $60 to borrow $100. Eventually, the consumer, unable to pay the increasing loan amount, will continue to roll over the loan and ultimately stumble into what amounts to a payday loan debt trap.

Were Payday Lenders Covered By Michigan Usury Laws?

Consumer advocates began the campaign to have states enforce existing usury laws against payday lenders. The payday lending industry countered the campaign by lobbying states to pass legislation that would provide safe harbor from coverage of the existing usury laws.

In Michigan, the payday lending industry has argued to the legislature that they are not covered by the existing usury laws because they do not make "loans" but rather "deferred presentment services." Likewise, they are not charging "interest," but rather "transaction/service fees." Thus, the payday lenders urged passage of a special payday loan law to regulate the industry.

Consumer advocates insisted that the payday lenders were indeed making loans and charging interest, and were already regulated by existing laws, such as the Regulatory Loan Act,[4] the Credit Reform Act,[5] the Usury Act,[6] and the Criminal Usury Act.[7] The Regulatory Loan Act required a person in the business of making loans to be licensed[8] and prohibited him or her from charging interest on the loan at a rate that exceeded the rate permitted under the Credit Reform Act.[9] The Credit Reform Act prohibits a regulated lender from charging interest or a finance charge at a rate beyond 25 percent per annum.[10] The general usury statute allows for a 5–7 percent interest rate.[11] The criminal usury statute provides that the interest rate on a loan cannot exceed 25 percent per annum.[12]

In an April 25, 1995, declaratory ruling, the Michigan Financial Institutions Bureau (FIB) announced that a check-cashing company that cashes a customer's check and agrees to delay presentment for payment of that check to the customer's bank until the customer's next payday is engaged in lending subject to the Regulatory Loan Act.[13] In 1995, the FIB commissioner also found that a fee paid for the delay in payment of money is interest as used in the Regulatory Loan Act. Therefore, according to the then FIB commissioner, engaging in the deferred presentment transaction without a license and not complying with the Regulatory Loan Act violated that act, as well as the general Usury Act and the Criminal Usury Act.

The conclusion that the payday lenders' "service fees" are interest is supported by the Michigan Supreme Court and other courts. The Michigan Supreme Court defines interest as "compensation allowed by law or fixed by the respective parties for the use or forbearance of money, 'a charge for the loan or forbearance of money,' or a sum paid for the use of money, *or for the delay in payment of money.*"[14] Additionally, courts that have addressed this question have held that the payday lenders' charges constituted "interest," not "service fees."[15]

Despite these issues, Michigan has enacted a payday loan statute that presumes that the payday lenders are not covered by existing Michigan laws.

Michigan's Deferred Presentment Service Transactions Act[16]

This act applies to businesses engaging in deferred presentment service transactions. The act requires payday lenders to be licensed and regulated by the Office of Financial and Insurance Services (OFIS). The act also requires a licensed lender to post prominently in an area designed to be seen by the customer before he or she enters into a deferred presentment service transaction certain disclosures about the transaction. The required disclosures are in effect a consumer's "bill of rights," which includes such features as limitations on multiple loans, rights to cancel loan agreements, prohibition against use of criminal processes for collection, etc.

Under the act, a licensee may enter into one deferred presentment service transaction with a customer for any amount up to $600. The maximum loan term is 31 days. There is a graduating fee schedule that ultimately allows a fee of $76 (that is, 12.7 percent) for a $600 loan. In practical terms, this 12.7 percent fee translates into an annual percentage rate of 330.2 percent for a two-week loan. This triple-digit interest rate, of course, far exceeds the 25 percent annual interest rate required by the Credit Reform Act.

Under the Deferred Presentment Service Transactions Act, a licensed lender cannot enter into a deferred

FAST FACTS

The Michigan legislature has authorized payday lenders to charge triple-digit interest rates for short-term loans.

Payday loans often carry triple-digit interest rates that far exceed limits set by Michigan usury laws.

Payday lenders have substituted the term "deferred presentment transaction" for "loan" and "transaction service fee" for "interest." For the consumer, their practices still amount to usury.

presentment service transaction with a customer if the customer has an open deferred presentment service transaction with the licensee or has more than one open deferred presentment service transaction with any other licensee. Thus, the maximum number of outstanding loans a customer can have at one time is two—one per lender or two with two different lenders. OFIS is required to develop and maintain a statewide database so the licensees can access the database to verify whether a customer has any open deferred presentment service transactions with any licensee.

Fortunately, the new legislation forbids rollovers. The act also provides for a repayment plan, but only after the eighth deferred presentment service transaction in any 12-month period. An additional fee is charged for the installment repayment plan.

OFIS may issue cease and desist orders or consent orders and may suspend or revoke a license. Additionally, a person injured by a licensee's violation of this act may sue the licensee and recover actual damages, an amount equal to any service fees paid, plus reasonable attorney fees. The statute, however, does allow a licensee to include an arbitration provision in a deferred presentment service transaction agreement.

Finally, the act provides that a person who provided deferred presentment service transactions in Michigan before the effective date of the act (June 1, 2006), is considered to have complied with applicable state law if he or she was in "substantial conformity" with the rulings and interpretive statements then in effect that were issued by the office or its predecessor agency. In the absence of any rulings other than the April 1995 ruling by the FIB commissioner, the phrase "substantial conformity with the rulings and interpretive statements then in effect" is left open to varying interpretations and possible litigation challenges. The Florida Supreme Court recently held that payday loans made before the enactment of that state's deferred presentment statute were covered by Florida's usury laws.[17]

As low-income consumers cope with the new law, their advocates will continue to explore new avenues and strategies for addressing a practice that has caused long-term grief for many who sought short-term financial relief. ◆

Lorray S.C. Brown is the managing attorney/consumer law attorney for the Michigan Poverty Law Program. She will chair the State Bar Consumer Law Section council during 2006–2007.

Footnotes

1. MCL 487.2121 et seq.
2. See http://www.paydayloaninfo.org/lstatus.cfm.
3. Paul Chessin, *Borrowing from Peter to pay Paul: A statistical analysis of Colorado's Deferred Deposit Loan Act,* 83 Denver Univ L R 387, 391 (2005).
4. MCL 493.1 et seq.
5. MCL 445.1851 et seq.
6. MCL 438.31 et seq.
7. MCL 438.41 et seq.
8. MCL 493.2.
9. MCL 493.13.
10. MCL 445.1854.
11. MCL 438.31.
12. MCL 438.41.
13. See http://www.michigan.gov/cis/0,1607,7-154-10555_20594_20597-51134—,00.html.
14. *Town & Country Dodge v Mich Dept of Treasury,* 420 Mich 226, 242; 362 NW2d 618 (1985) (quoting *Balch v Detroit Trust Co,* 312 Mich 145, 152; 20 NW2d 136 (1945)) (emphasis added).
15. *Hamilton v York d/b/a HLT Check Exchange,* 987 F Supp 953, 955–57 (ED KY 1997); *Turner v E-Z Check Cashing,* 35 F Supp 2d 1042, 1047–49 (MD Tenn 1999).
16. MCL 487.2121 et seq.
17. *Check Advance v Betts,* 928 So 2d 1204 (2006).