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**PRESENTATION OF
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
OFFICE OF CONSUMER PROTECTION**

TO THE HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE

**TWENTY-FIFTH STATE LEGISLATURE
REGULAR SESSION OF 2009**

Thursday, January 29, 2009
2:00 p.m.

TESTIMONY ON HOUSE BILL NO. 447 – RELATING TO PAYDAY LENDING.

TO THE HONORABLE ROBERT N. HERKES, CHAIR, AND MEMBERS OF THE
COMMITTEE:

The Department of Commerce and Consumer Affairs ("DCCA") appreciates the opportunity to testify regarding House Bill No. 447, Relating to Payday Lending. My name is Stephen Levins, and I am the Executive Director of the Office of Consumer Protection ("OCP"), representing the Department.

House Bill No. 447 proposes several amendments to Hawaii's Check Cashing law, Chapter 480F of the Hawaii Revised Statutes, many of which are not in the interest of consumers. Of particular importance to the Department are the following provisions:

- (1) it requires check cashing businesses to register with the DCCA;

- (2) it authorizes additional fees currently prohibited by law;
- (3) it authorizes payment plans;
- (4) it requires record keeping;
- (5) it exempts the proceeds obtained from the fees and interest payments from the state general excise tax;
- (6) it imposes various disclosure requirements regarding the loans; and
- (7) it allows for the imposition of attorneys fees, which are currently prohibited by law.

Registration

The DCCA does not believe that a registration requirement is necessary at this time. The OCP has not encountered any problems with the enforcement of Chapter 481F due to any lack of registration by check cashing companies. On the contrary, anytime that the OCP has attempted to locate a company pursuant to an investigation, it has been able to do so with minimal effort. Consequently, imposing a registration program on DCCA and these companies for the apparent purpose of identifying the names and addresses of check cashing companies does not appear to be warranted and may in fact cause the Department to expend additional resources without providing any appreciable increase in protection for consumers.

Fees

The Department is opposed to authorizing any additional fees that are not already permitted under existing law. Current law already authorizes extraordinary interest rates on consumers. The annual percentage rate on the average \$300 two-week payday loan in Hawaii is currently 459%. Under these circumstances, saddling borrowers with additional costs would be unnecessarily burdensome. Consequently, the Department is opposed to the allowance of any so called administrative fees", interest for "uncollected judgments", and/or increasing the "dishonored check" fee.

Payment Plans

It is unclear why extended repayment plans are needed. Of particular concern to the Department is that the payment plan provisions in this bill appear to sanction rollovers which are specifically prohibited by Section 5 (d), of Chapter 481F. For this reason, DCCA is currently opposed to this proposal.

Record Keeping

The Department is not opposed to imposing a record keeping requirement on Payday Lenders.

General Excise Tax Exemption

The Department does not believe that there is any rationale for exempting the check cashing industry from paying the general excise tax.

Disclosure Requirements

The Department believes that the conspicuous disclosure of fees charged to consumers is meritorious. Full and complete disclosure of all material terms to a loan agreement is a fundamental tenet of consumer protection. This is the foundation of the Truth in Lending Act. Consequently, the Department is not opposed to the imposition of additional disclosure requirements.

Out of Pocket Legal Costs (Attorney Fees)

The Department is opposed to the imposition of attorney fees and or legal costs on the borrower. Since payday loans already yield the highest interest rates of any loan, it appears fundamentally unfair to the consumer to be saddled with these additional fees. If attorney or legal fees were authorized, the borrower could actually end up owing more in legal costs than the original amount of the loan.

Thank you for this opportunity to testify on House Bill No. 447. I will be happy to answer any questions that the members of the Committee may have.

LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
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KURT KAWAFUCHI
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**HOUSE COMMITTEE ON CONSUMER PROTECTION & COMMERCE
TESTIMONY REGARDING HB 447
RELATING TO TAXATION**

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)

DATE: JANUARY 29, 2009

TIME: 2:009M

ROOM: 325

This bill, among other things, provides a general excise tax exemption for proceeds received by check cashers.

The Department defers to the Department of Commerce & Consumer Affairs with regard to whether or not check casher regulation is warranted. However, the Department of Taxation **opposes** providing a general excise tax (GET) exemption to check cashing businesses.

I. GET EXEMPTION FOR CHECK CASHING TRANSACTIONS IS RESERVED TO FINANCIAL INSTITUTIONS UNDER CHAPTER 241.

The general excise tax exemption allowed for financial institutions and financial-related transactions is set forth at HRS § 237-24.8. This general excise tax exemption, as well as the exemption from income tax under Chapter 235, is given in return for taxation of financial institutions under Chapter 241.

In exchange for not being taxed under the ordinary income tax law nor being taxed under the general excise tax law, a financial institution is taxed under Chapter 241 at the rate of 7.92% of net income. Chapter 241 applies only to financial institutions, as defined, which does not include "check cashers". If this bill were to become law, check cashers would stand to recognize a potential windfall that traditional banks would not realize. For example, a "check casher" would be subject to the income tax, but be exempt from the general excise tax when a traditional bank would be exempt from both in exchange for the higher Chapter 241 net income tax rate.

II. MERITS OF THE BILL, SPECIFICALLY.

With regard to the text of the bill, the Department suggests that its wording could be

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tightened. For example, the terms "fees and interest" are undefined. What amounts to a fee would be left to the "check casher" to define, which could be the subject of abuse.

Based on the foregoing, the Department suggests that this Committee eliminate the general excise tax provisions of this bill.

This bill would result in a revenue loss of approximately \$4 million annually.

TAXBILLSERVICE

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TAX FOUNDATION OF HAWAII

Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Exempt check casher fees

BILL NUMBER: HB 447

INTRODUCED BY: Belatti, Brower, C. Lee, M. Lee, Luke, Wakai, and 1 Democrat

BRIEF SUMMARY: Adds a new paragraph to HRS section 237-24.75 to exempt from the general excise tax amounts received by a check casher as fees and interest on deferred deposit transactions under HRS chapter 480F.

Makes other nontax amendments related to check cashing businesses and retailers who occasionally cash checks.

Repeals this section on June 30, 2011.

EFFECTIVE DATE: July 1, 2010

STAFF COMMENTS: It should be remembered that the general excise tax is a tax imposed for the privilege of doing business in Hawaii. The tax is measured against the gross proceeds received by a business as a result of providing goods or services to a customer. While this measure proposes to exempt check casher fees and interest on deferred deposit transactions, it would grant a tax preference for a particular profession while other taxpayers would remain subject to the tax. Generally tax relief is granted to alleviate an undue burden on the taxpayer based on that taxpayer's ability to pay the tax. This proposed exemption would grant relief to taxpayers without regard to their ability to pay the tax.

Granting this exemption merely insures that those engaged in the check casher business are assured another 4%/4.5% margin of profit since the tax will not have to be paid.

Digested 1/28/09

The Honorable Robert N. Herkes, Chair
The Honorable Glenn Wakai, Vice Chair
House Committee on Consumer Protection and Commerce

Hearing : Thursday, January 28, 2007, 2:00 p.m.
State Capitol, Conference Room 325

IN SUPPORT OF THE INTENT OF HB 447

Chair and Members of the Committees:

My name is Ryker Wada, representing the Legal Aid Society of Hawai'i ("LASH"). I am advocating for our clients who include the working poor, seniors, citizens with English as a second language, disabled and other low and moderate income families who are consumers. While we are testifying **in support of the intent** of HB 447 there are **major flaws with the bill which must be corrected.**

According to the National Consumer Law Center's memo on predatory small loans, the State of Hawaii falls into category 3 of states that regulate "payday loans." These category 3 states have specifically passed statutes to allow payday lending. In recent years, the majority of mainstream lenders have left the small loan market, leaving a vacuum being filled by companies offering payday loans. These are extremely high interest loans that extend until the borrower's next pay check. The national finance companies, which were initially founded to meet precisely this credit need, have moved out of this type of small lending. As a result, the availability of small-sum, short-term credit has been severely curtailed.

Much of the market for small unsecured loans today has been replaced by checking account overdraft loans and credit cards, even for relatively lower income households. From 1993 to 1996, the proportion of households with incomes under \$20,000 who received credit card offers rose from 40% to 50%. This still leaves a large number of consumers without sufficient credit card limits or bank overdraft protection to meet their needs for relatively small unsecured loans, and who no longer have access to traditional sources of small loans. At the same time as traditional lenders were exiting the

small loan market, the elimination of interest rate caps that began in the 1980's made this niche attractive to new entrants.

The abuses occur in the making and collection of payday loans in a variety of ways. Cash-strapped consumers rarely have the ability to repay the entire loan when their paydays arrive because that leaves little or nothing on which to live until the next pay check. The result is that the consumer pays another round of charges and fees and obtains no additional cash in return. For example, if a consumer is charged 10% on the face amount of the check of \$200, the consumer receives only \$180 in cash and the lender pockets a \$20 fee. The APY is 214% if this loan is repaid in 30 days. These loans are exorbitantly expensive and can drive consumers ever deeper into debt.

Aside from attempting to regulate the payday lending industry, HB 447 has several provisions that would be detrimental to consumers in the State of Hawaii. Most significant is Section 5 of the bill amending HRS 480F-4 to allow for collection of principal, interest and legal costs associated with insufficient funds checks. Currently check cashers can only recover a small fee for a dishonored check. This change has the potential to create a situation where someone defaults on a \$300 payday loan and then be liable for thousands of dollars in collection fees and attorney costs. Additionally this may create a market for debt collection agencies to buy up these debts. This section also attempts to allow payday lenders to collect additional interest and increases the fee for a dishonored check fee from \$20 to \$30. Neither of these provisions should be allowed.

HB 447 also attempts to amend HRS 480F to include language allowing for varied payment plans for customers who may or may not be in default. While the Legal Aid Society is in favor of allowing payment plans for consumers, the language in HB 447 is confusing and needs to be clarified. HB 447 would also add an "administrative fee" for application of the plan. No fee should be allowed and the language detailing the plans should be clarified.

HB 447 would also exempt money received by payday lenders from fees and interest from the state General Excise Tax. The Legal Aid Society of Hawaii does not have a position on this portion of the bill but believes it should be noted.

Conclusion:

We appreciate these committees' recognition of the problems associated with payday lending in the State of Hawaii and your efforts to address them. While the intent of HB 447 is good, in its present form HB 447 would expand the ability of check cashing businesses to recover damages against consumers relating to interest and out of pocket legal expenses. This has the potential to irreparably harm consumers in the State of Hawaii. While we support regulation of the payday lending industry,

HB 447 should be amended to delete provisions relating to allowing attorneys fees, increasing bad check fees and allowing post judgment interest. HB 447 has the potential to strengthen protections for consumers by increasing the registration requirements for check cashing businesses. We support the intent of HB 447. Thank you for the opportunity to testify.

HACBED

Community Voice, Collective Action

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House Committee On Consumer Protection & Commerce
Thursday, January 29, 2009 at 2:00 pm
Conference Room 325

HB447 HD1 – Related To Payday Lending
Support The Intent

Dear Chair Herkes, Vice Chair Wakai, and Committee Members:

The Hawai'i Alliance for Community Based Economic Development (HACBED) is submitting testimony supporting the intent of HB 447 that would require check cashing institutions to register with the Department of Commerce and Consumer Affairs and further clarify disclosure requirements for fees and annual percentage rates.

Alternative financial services such as deferred deposit agreements, or payday loans, and check cashing can needlessly strip working families of hard earned income. Adopting regulations that insures the appropriate use of these financial services should be a state priority and is applauded.

For the purposes of this bill, it might be useful to define the differences between check cashing and payday lending. **Check Cashing** is the practice of charging a fee to a customer who brings in a check. Hawai'i Revised Statutes 480F-3 regulates the following fees for check cashing:

Except as provided in section 480F-4, no check casher shall charge fees in excess of the following amounts:

- (1) Five per cent of the face amount of the check or \$5, whichever is greater;
- (2) Three per cent of the face amount of the check or \$5, whichever is greater, if the check is the payment of any kind of state public assistance or federal social security benefit payable to the bearer of the check;
- (3) Ten per cent of the face amount of a personal check or money order, or \$5, whichever is greater; or
- (4) No more than \$10 to set up an initial account and issue an optional membership or identification card, and no more than \$5 for a replacement optional identification card.

Payday Lending involves payday loans that are short-term cash loans

based on the borrower's personal check held for future deposit or on electronic access to the borrower's bank account. Borrowers write a personal check for the amount borrowed plus the finance charge and receive cash. In some cases, borrowers sign over electronic access to their bank accounts to receive and repay payday loans. In Hawai'i, the equivalent **Annual Percentage Rate (APR) allowed for a payday loan is 459%**. Hawai'i Revised Statute 480F-4 regulates deferred deposits or payday loans in the following fashion:

- (a) No check casher may defer the deposit of a check except as provided in this section.
- (b) Each deferred deposit shall be made pursuant to a written agreement that has been signed by the customer and the check casher or an authorized representative of the check casher. The written agreement shall contain a statement of the total amount of any fees charged for the deferred deposit, expressed both in United States currency and as an annual percentage rate. The written agreement shall authorize the check casher to defer deposit of the personal check until a specific date not later than thirty-two days from the date the written agreement was signed. The written agreement shall not permit the check casher to accept collateral.
- (c) The face amount of the check shall not exceed \$600 and the deposit of a personal check written by a customer pursuant to a deferred deposit transaction may be deferred for no more than thirty-two days. A check casher may charge a fee for deferred deposit of a personal check in an amount not to exceed fifteen per cent of the face amount of the check. Any fees charged for deferred deposit of a personal check in compliance with this section shall be exempt from chapter 478.
- (d) A check casher shall not enter into an agreement for deferred deposit with a customer during the period of time that an earlier agreement for a deferred deposit for the same customer is in effect. A deferred deposit transaction shall not be repaid, refinanced, or consolidated by or with the proceeds of another deferred deposit transaction.
- (e) A check casher who enters into a deferred deposit agreement and accepts a check passed on insufficient funds, or any assignee of that check casher, shall not be entitled to recover damages in any action brought pursuant to or governed by chapter 490. Instead, the check casher may charge and recover a fee for the return of a dishonored check in an amount not greater than \$20.
- (f) No amount in excess of the amounts authorized by this section and no collateral products such as insurance shall be directly or indirectly charged by a check casher pursuant or incident to a deferred deposit agreement. [L 1999, c 146, pt of §1; am L 2001, c 20, §1; am L 2003, c 222, §1]

Currently, **Hawai'i is 1 of only 4 states that do not require a license to provide payday loans.** Requiring payday lenders to register and report annually information related to their business practices to the DCCA would be a prudent step that would align Hawai'i with other state practices in regulating payday loans.

HACBED supports the following policy options to regulate check cashing and payday lending:

1. ***Requiring check cashers and payday lenders to be registered, and more importantly, licensed with the state.*** We recognize that licensing would require additional resources devoted to DCCA in order to fulfill a robust licensing scheme.
2. ***Clarification that a customer can not receive a payday loan if they currently have an open loan from any source.*** Currently there is interpretation that as long as the customer does not have a loan from the place of establishment, it is acceptable to offer another loan. This can lead to customers having open loans from multiple sources.
3. ***Further disclosure of fees and annual percentage rates charged.*** In some cases, customers may not understand the long term impact of continual reliance on check cashing or payday lending. This should include information on financial education resources.
4. ***Review of annual rates charged on payday loans.*** Recently, the Department of Defense advocated for a maximum of 36% APR on any payday loan distributed to a service member. 11 states regulate payday loans through usury laws or small loan regulations.

At this time, there has not been an agreement from all interested parties to the appropriate form of check cashing and payday lending regulation. We believe that increased opportunities for key stakeholders to collaboratively problem solve would help in this regard. We, therefore, welcome the opportunity to continue to provide information and perspective on these issues.

Thank you for your consideration.

Sincerely,

Brent Dillabaugh
Policy Coordinator
HACBED

To: Rep. Robert N. Herkes, Chair
Rep. Glenn Wakai, Vice-chair
Committee on Consumer Protection and Commerce

From: R. Craig Schafer, President
Money Service Centers of Hawaii, Inc.

Date: January 28, 2009

Subject: In support of HB447

Money Service Centers of Hawaii, Inc. is the largest locally owned money service business in Hawaii. Headquartered in Kapaa, Kauai, we operate 12 fee-based money service centers throughout the State under the trade name PayDayHawaii. We have always supported legislation promoting the responsible use of short-term credit.

The original language in HB447 was developed by FSPoH, HACBED and the Hawaii Legal Aid Society to introduce more consumer protection to HRS 480F which regulates check cashing including deferred deposit transactions commonly call payday advances. Financial Service Providers of Hawaii (FSPoH) is a trade association of check cashers and non-bank financial services doing business in the State of Hawaii.

Money Service Centers of Hawaii, Inc. supports the consumer protection provisions and increased disclosure in HB447. Registration would be beneficial to consumers who have a right to expect the financial businesses they patronize to comply with the law. Registration of check cashers will help the DCCA identify those business governed by HRS 480F and help ensure compliance.

We support posting of the Annual Percentage Rate (APR) along with the current requirement to post the fee. APR, which is sometimes misunderstood as interest, is a measure of the true cost of credit including all fees and finance charges. It was designed by the Federal Government as a universal way to allow consumers to make informed credit decisions. Deferred deposit transactions require the disclosure of APR under Regulation Z of the Truth in Lending Act. Posting the range of fees in a conspicuous place will help ensure that payday loan customers better understand this transaction is not a long-term credit solution.

The excess use of short-term credit to solve long-term credit problems should be discouraged. When a consumers borrow repeatedly, what is often termed "rolling over", the compounding effect can be a real drain on their finances. A consumer who gets into this "cycle of debt" will spend hundreds of dollars over the course of a year to (in effect) refinance the original loan. This is not the intent of the product and these consumers should be encouraged to seek out a longer-term loan from a bank, credit union or finance company. To discourage the excessive use of deferred deposit transactions HB447 requires:

- 1) An offer of an interest free payment plan with a minimum term of 60 days for consumers in default. All collection letters must inform the consumer of this option.

- 2) Requires a notice to the consumer on the contract that a payment plan option is available after four or more consecutive deferred deposit transactions. The payment plan option for non-default consumers may be up to 90 days. No interest may be charged but a late/administrative fee of \$30 may be added. A 30-day cooling off period is mandatory after completing a payment plan.

Another serious situation can occur if the consumer pyramids payday advances by going to multiple lenders. These are the people cited by critics of our product who owe thousands of dollars with no hope of repayment. This practice has the same effect as juggling dozens of easily obtainable credit cards. HB447 allows only one deferred deposit transaction per consumer at a time. Consumers must also be warned in signage and on the contract that deferred deposit transactions are not suitable for long-term borrowing.

HB447 removes the exemption (480F-5-1) to protect consumers from any entity, other than banks and financial institutions, cashing checks for a fee. Retailers who cash checks over \$1000, such as Wal-Mart, are required to register as a Money Service Business (MSB) with the U.S. Treasury Department because of the Patriot Act. They should not be exempt from registration under Hawaii state law.

HB447 exempts deferred deposit transaction fees from General Excise Tax. A deferred deposit transaction is considered a form of credit. These transactions are subject to truth in lending Regulation Z requirements like a bank loan. Consumers who pay interest on advances to financial institutions do not pay GET on the interest and fees on those advances (HRS 237-24.8).

Payday advances are most often used by low income and working class consumers with poor credit history. In this case, GET on deferred deposit type of credit is a classic regressive tax. Low-income consumers are subject to the tax while high-income consumers who qualify for credit from financial institutions are exempt from the tax. Low-income and poor credit consumers already pay a higher rate for credit than high-income credit worthy consumers.

HB447 provides for a 24 hour right of rescission on deferred deposit transactions. This provision gives consumers an opportunity to read the "fine print" without feeling rushed so they can completely understand the transaction.

There is one amendment we suggest. HB447 should require that deferred deposit transactions be tied to income. We suggest the total amount of the transaction including fees should be no more than 30% of gross monthly income. This underwriting standard protects very low-income consumer from excessive fees. It also is a reasonable standard to assure ability to repay and avoid the cycle of debt.

Sincerely,

R. Craig Schafer
President,
Money Service Centers of Hawaii, Inc.
1/28/2009