



C A L I F O R N I A D E P A R T M E N T O F C O R P O R A T I O N S

Report to the Governor and the Legislature
As Required By Financial Code Section 23057

CALIFORNIA DEFERRED DEPOSIT TRANSACTION LAW

California Department of Corporations

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DEPARTMENT OF
CORPORATIONS



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Executive Summary

Payday loans are short-term lending transactions where a borrower writes a postdated check to a lender who provides immediate cash, and the check is deposited on the borrower's next payday. Nationwide, the payday loan volume has increased from \$3.5 billion in 1998 to \$40 billion in transaction volume in 2005. In California, the transaction volume for the past two years has remained relatively stable at \$2.5 billion. In 2006, 1.4 million Californians took out payday loans. Costs for these transactions are limited to 15% of the face value of the check. Due to the short length of the transaction, however, usually representing a two-week pay period, the annual percentage rates for these loans are higher than 400%.

When the Legislature transferred the payday lending industry to the jurisdiction of the Department of Corporations, the Legislature required the Department to prepare an assessment and submit a Report to the Governor and Legislature by December 1, 2007. That report must contain an assessment of consumer demand for payday loans, trends in the industry and recommendations for potential legislation that may be needed to protect the people of the State of California. That assessment and Report follows.

Demand, as a function of consumer usage of payday loans, is high in California. The largest group of payday loan customers engage in two to five payday transactions per year. Within that group, the vast majority of customers take out payday loans in a repetitive fashion, taking out a new loan within five business days of paying off a prior loan. A large number of customers take out only one loan during the year. Finally, a substantial number of customers are perpetual users of payday loans.

The Department's recommendations for potential legislative action can be broken into two large categories: recommendations to improve regulatory oversight of the industry, and recommendations to strengthen enforcement. The Department also included other options for the Legislature's consideration regarding regulation of the payday loan product.

Since the payday industry meets consumer needs, the industry serves a valuable purpose. Consideration should be given to whether this purpose can be achieved in a less expensive way for consumers, while at the same time allowing companies to profit. The Department is willing to work with the industry, consumer groups, and the Legislature to find statutory language that reaches that balance.



Introduction

Effective December 31, 2004, the Legislature transferred jurisdiction of payday lenders to the Department of Corporations (Department) from the Department of Justice. The legislation effectuating the transfer, as amended, contains a statutory requirement that the Corporations Commissioner submit a report on December 1, 2007, to the Governor and Legislature regarding the implementation of the Department's jurisdiction over the industry (see Financial Code section 23057). That same statutory provision directs the Department to include in the contents of the report information regarding "demand for deferred deposit transactions, the growth and trends in the industry, common practices for conducting the business of deferred deposit transactions, the advertising practices of the industry..., and any other information the Commissioner deems necessary to inform the Governor and the Legislature regarding potential legislation that may be necessary to protect the people of the State of California." This Report constitutes the Department's study of the industry, in compliance with that statutory provision. The Department has organized the Report around the above-referenced statutory language.

Recommendations in this Report can be categorized generally as recommendations to improve regulatory oversight of the industry and recommendations to strengthen enforcement, together with other options regarding payday loan transactions. The Department substantiates its recommendations from a number of sources, including regulatory examinations conducted by the Department, review of existing laws in California, review of comparable laws from other states, industry best practices, and other studies. Finally, the recommendations assume the continued existence of payday lending in the State, whether in its current form or in tandem with other products or consumer protections. In addition, the Department has included other options regarding the payday loan product.

At the inception, we note that this Report comprises the first of two parts. The Department retained an independent research group, Applied Management and Planning Group (AMPG), to survey both the licensees and the consumers in order to provide in-depth and objective data on several variables. The Department is providing an additional report to the Governor and Legislature, containing the findings of the research group, and further confirming the need for the recommendations described above.



Chapter 1

Overview of Deferred Deposit Transactions and Implementation of Department Regulation

California is one of 37 states that, along with the District of Columbia, permit payday lending. California's statutory nomenclature for the payday loan is a "Deferred Deposit Transaction" and the enabling legislation is the California Deferred Deposit Transaction Law (CDDTL). The transaction constitutes a cash advance a lender makes to a borrower, who writes a check to the lender. Under the terms of an agreement between the lender and borrower, required to be in writing, the lender agrees to defer deposit of the check into the lender's bank account until an agreed upon future date. Lenders may charge a fee of 15% of the face amount of the check, but no check may have a face value greater than \$300. Only lenders who are licensed by the Department may make such payday loans in California. By statute, the following persons are not subject to the licensing requirements of the CDDTL:

- State or federally chartered bank, thrift, savings association, industrial loan company or credit union.
- Retail seller engaged primarily in the business of selling consumer goods, including consumables, to retail buyers that cashes checks or issues money orders for a minimum fee not exceeding \$2 as a service to its customers that is incidental to its main purpose of business.

Payday loans provide an immediate source of short-term credit to meet emergency cash needs of consumers that may not have access to traditional sources of credit or elect not to use other sources of credit available to them. Payday loan stores are located in close proximity to the customers. Many times, the transaction can be completed in 15 minutes or less. Payday lenders rarely perform time-consuming credit checks or evaluate the borrower's ability to repay the loan on the due date. Instead, the borrowers are required to provide information easily available to them, such as identification, proof of residence, recent pay stub and checking account information.

Since the Department obtained jurisdiction over payday lenders, it has compiled annual reports for payday transactions in the State. A copy of the 2006 Report appears as Appendix One to this Report. Table 1-1, on the following page, constitutes an excerpt from that Annual Report.

Table 1-1
Summary of Deferred Deposit Transactions for 2005-2006

	2005	2006	Percentage Change
Total Dollar Amount of Deferred Deposit Transactions Made	\$2,479,725,858	\$2,553,472,572	+2.97%
Total Number of Deferred Deposit Transactions Made	9,785,004	10,048,422	+2.69%
Total Number of Individual Customers Who Obtained Deferred Deposit Transactions (repeat customers counted once)	1,536,600	1,432,844	-6.75%
Average Number of Deferred Deposit Transactions Made to Each Individual Customer (Total Number of Deferred Deposit Transactions Made Divided by Total Number of Individual Customers Who Obtained Deferred Deposit Transactions).	6.37	7.01	+ 10.05%
Average Dollar Amount of Deferred Deposit Transactions Made	\$253	\$254	+. 40%
Average Number of Days of Deferred Deposit Transactions	17	16	- 5.88%
Average Annual Percentage Rate	426%	429%	+. 70%

As of December 31, 2007, there were 2,403 licensed payday stores in California. The aggregate volume of payday transactions in the State exceeded \$2.5 billion as of year-end 2006, representing more than 10 million transactions. The average length of a transaction was 16 days. The industry experiences a relatively small amount of charge-offs, roughly 3% of overall annualized volume. These figures were comparable for year-end 2005. No similar statistical data exists prior to December 31, 2004.

One national payday and check cashing company estimates the national loan volume for 2005 was \$40 billion, and \$6 billion of revenues. The Annual Report (10-K) for Ace Cash Express, Inc. for fiscal year 2006 is available at www.sec.gov.

The Department has not prepared any aggregate profitability analysis for the payday businesses. To do so would be difficult for a number of reasons, including the fact that the payday stores contain ancillary businesses, such as check cashing operations, money transmitters, or other businesses. Separating out the payday business line profitability would be difficult. The payday business constitutes a high volume business, however, with very low overhead. Given the number of stores operating in the State, the volume of transactions, low overhead costs, and negligible charge-offs, it is reasonable to conclude that the businesses experience healthy profit margins.

Regulatory Examinations

The CDDTL provides that the Department may at any time, but not less than once every two years, investigate the business of deferred deposits, and examine the books, accounts, records and files of every licensee. The purpose of the regulatory examination is to determine compliance with the CDDTL and the rules and regulations established by the Commissioner.

The Department began conducting regulatory examinations in the second half of 2005. In the course of its examinations, the Department observed certain practices and charges that, while consistent with the statute, may not reflect the Legislature's intent. Specifically, the practice concerns the duration of the transaction, and the charge concerns the actual dollars incurred by consumers for transactions.

As reflected in the Annual Report for CDDTL, the average length of transactions is far less than 31 days, approximately two weeks, which typically represents one pay period. The short term of the transaction has the effect of increasing the cost of the transaction to the consumer, especially if that cost is viewed as an annualized cost such as an APR.

In addition to the length of the transaction, in order to borrow \$100, the consumer actually pays \$117.65. That is because the statute permits the lender to charge 15% of the face value of the check. To receive \$100 the borrower pays the face value of the check (\$117.65) minus the fee (.15 x \$117.65 = \$17.65).

As an observation, the cost of these transactions to consumers can be reduced, and businesses could still profit from the transactions, if the costs of the transactions are reflected only as fees rather than as percentages. In other words, if the statute permits the lender to charge \$15 for every transaction where the borrower takes out a loan for \$100, then the total cost to the borrower where the borrower receives \$100 would be \$115. As another observation, if the length of the transactions were at least 31 days, rather than up to 31 days, the costs of the transactions would be reduced further. Table 1-2, on the following page, reflects the annualized costs of these transactions with varying charges permitted, \$15 per \$100 and \$12 per \$100.

Table 1-2

Amount Borrowed	Fee	Total Loan Amount (Face Amount of Check)	APR 15 Day Term	APR 31 Day Term
\$100	* \$17.65	\$117.65	429.41%	207.78%
\$100	** \$15.00	\$115.00	365.00%	176.61%
\$255	* \$45.00	\$300.00	429.41%	207.78%
\$300	** \$45.00	\$345.00	365.00%	176.61%
\$100	*** \$12.00	\$112.00	292.00%	141.29%
\$300	*** \$36.00	\$336.00	292.00%	141.29%
\$750	**** \$75.00	\$825.00	243.33%	117.74%

* Fee of 15% of the face amount of the check, which is the maximum permitted under existing law.

** Fee of 15% of amount borrowed

*** Fee of 12% of amount borrowed

**** Fee of 10% of amount borrowed

Compliance with the letter of the law appears to be the biggest challenge the payday industry faces. On balance, the larger companies have fewer compliance violations than the smaller companies, in part due to internal compliance departments that oversee operations. Industry initiatives emphasize compliance and best practices as well, but many of the small operations, such as sole proprietorships, do not participate in these industry groups. Follow up examinations reveal fewer violations than noted during the initial exams, indicating the industry corrects the violations noted during the regulatory exam.

In its publication *Deferred Deposit Originator Bulletin* (February 2007), available to all licensees and the public, the Department informed the industry that the level of non-compliance with the CDDTL discovered during the regulatory examinations performed to date was a major concern, with emphasis placed on the violations relating to disclosures and information licensees are required to provide to the customers in connection with the deferred deposit transaction. However, violations related to illegal rollovers were not one of the major violations discovered during the regulatory examinations.

As a result of the high level of non-compliance disclosed, the Department modified its practices and began to issue citations during the course of its examinations. Therefore, on July 3, 2007, the Department notified all licensees of the change in its practices and explained that citations in an amount not to exceed \$2,500 for violations discovered during the regulatory examinations would be issued. The licensees were again reminded that more serious violations would be referred to the Department's Enforcement Division for actions that could include, but not be limited to, citations, suspension of the license, revocation of the license and voiding of the loans.

In order to make the disciplinary process more efficient, the Department implemented a program to issue citations and desist and refrain orders to licensees during the regulatory examination process. In July 2007, the Department began issuing the citations through the regulatory process. As of December 31, 2007, the Department had issued 44 citations. Most citations were based on violations involving lack of or incomplete notices and disclosures required by law.

Summary of Consumer Complaints

The Department has not received consumer complaints involving payday lenders in any substantial amount, especially in the context of the number of licensed locations and number of deferred deposit transactions made in California. From July 1, 2006 to December 31, 2007, the Department received 66 written complaints against payday lenders. With approximately 10 million transactions occurring each year, this complaint volume is very low.

The most common complaint was against unlicensed payday lenders conducting deferred deposit transaction business over the Internet. From July 1, 2006 to December 31, 2007, the Department received 20 complaints against unlicensed Internet payday lenders. Most of the unlicensed Internet payday lenders were located in other states, some in other countries. Unlicensed Internet payday lenders commonly do not comply with various provisions of the CDDTL by offering larger loans and loans with different terms, charging excessive fees, and providing inadequate disclosures and employing questionable collection practices.

The next most common complaint involved nine complaints related to collection practices, including phone calls and threats. The nature of the remaining complaints varies, not reflecting a common pattern. For processing complaints, excluding unlicensed activity, the Department provides a copy of the complaint to the licensee. The licensee is requested to investigate the complaint, inform the complainant of the results of the investigation and provide a copy to the Department. The complaint is closed if the response is adequate. Those complaints that involve serious violations of the CDDTL are referred to the Department's Enforcement Division for disciplinary action against the licensee.

More recently, the Department has received a number of complaints from military service members who are presently unable to obtain payday loans, as a result of the implementation of Assembly Bill 7 (Chapter 358, Statutes of 2007) as of October 2007. That law essentially forbids payday lending to members of the military and their dependents. Since the law has only recently been enacted, the Department has not had ample time or experience to assess its corollary effects, if any.

Assessment for Costs and Expenses for Administration of the CDDTL Program

The Department receives funding for the regulation and enforcement of the payday loan program through assessments paid by the industry. Each licensee must pay to the Department the pro rata share of all costs and expenses reasonably incurred in the administration of the CDDTL program. For the State fiscal year of 2005/06, the assessment was \$500 per location. That increased in the current 2007/08 fiscal year to \$941 per location. Failure to pay the assessment may form the basis for summary revocation of the lender's license by the Commissioner.



Chapter 2

Demand For Payday Loans

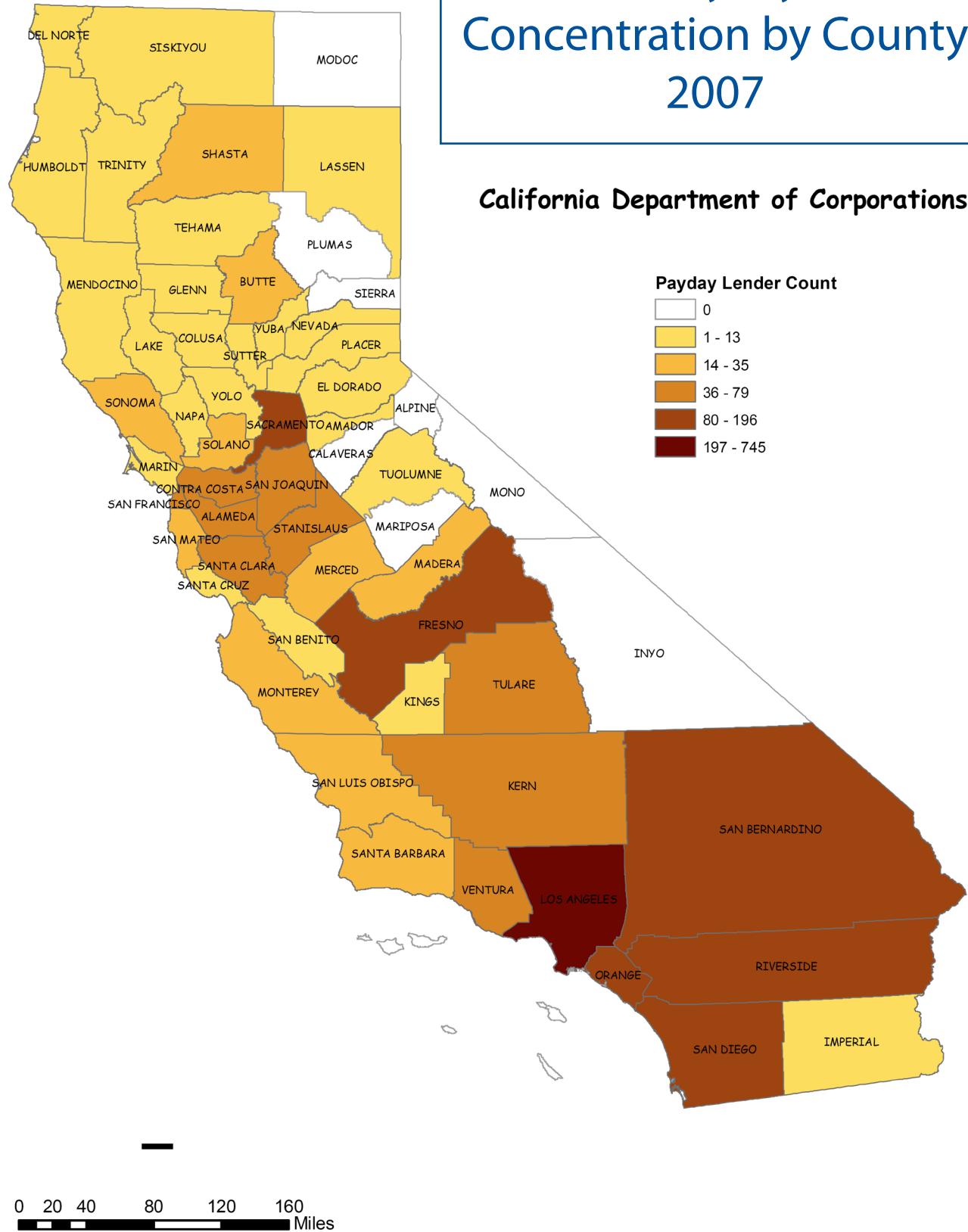
Although the statutory language requiring this Report calls for a discussion of “information regarding demand for deferred deposit transactions,” the statute does not contain a definition of “demand.” Demand for a product can be measured in various ways. Aggregate sales volume may reflect one measure of demand if there are no constraints on supply. In other words, assuming anyone who has a checking account and can verify their income wants to take out a payday loan, and the lenders can make such loans to everyone who so qualifies, the actual demand would amount to the aggregate sales volume. By that measure, the aggregate demand has been relatively stable in California over the past two years, at \$2.5 billion. Payday loan volume appears to be concentrated in the more densely populated urban areas of the state. The concentration of licensed locations by county is reflected in Map 2-1 on the following page. Based on the annual reports from the licensees and other data collected by the Department, the total population of payday loan customers in California is estimated to be approximately 1.5 million.

To be sure, other measures of demand exist. One such measure would capture those individuals who apply for a loan, but fail to qualify. Lenders are not required to retain such data, however, and rarely do so. A demand measure that would include those individuals without a checking account, who may desire to obtain a payday loan, would not reflect demand for the product, however, since the product is predicated on the existence of a checking account. Such a measure may reflect demand for financial assistance, but not a payday loan product.

Artificial and unmet demands for a product may exist. Artificial demand may exist if advertisements or other promotions encourage demand beyond consumer needs or desires. Unmet demand may exist if there exists an insufficient availability of products or products with insufficient loan limits. The consumer survey and focus groups to be conducted by AMPG may capture some of these measures of demand, and such information will be included in their supplemental Report.

For purposes of this Report, the Department construes demand as a function of iterative consumer transactions for payday loans, a definition that reflects the number of times, on average, a consumer engages in payday loan transactions in a year. To evaluate consumer demand in this regard, the Department issued a survey to its licensees. The Department designed the survey to measure the frequency with which consumers actually take out payday loans, on average, during the course of calendar year 2006. Specifically, the survey used a window of five business days to measure consumer behavior in this regard. For customers who paid off one payday loan and did not take out another until after five business days elapsed, the survey captured that level of payday use as “intermittent.” For customers who paid off a loan and took out another before five business days elapsed, the survey captured such transaction usage as “consecutive.”

Map 2-1



Under the CDDTL, there is no limit on the number of payday loans a licensee may make to a borrower in any given period of time. A licensee cannot make a new deferred deposit transaction during the period an earlier deferred deposit transaction is in effect for the same customer, and the proceeds of a new deferred deposit transaction may not be used to pay off an existing deferred deposit transaction from the same licensee. A licensee is permitted to make a new loan to a customer on the same date the previous loan is paid off. There is no mandatory time period that a licensee must wait before making a new loan to a borrower once the previous loan is paid off.

The Department determined that information regarding the frequency that consumers use the loan product would assist in evaluating the true demand for the loan product. The Department wanted to examine the extent to which the use of the payday loan is self-perpetuating. The results of the Survey consolidated for the industry are summarized below in Table 2-1.

Table 2-1
California Deferred Deposit Transaction Law Survey
January 1, 2006 to December 31, 2006

	Continuous (Consecutive) Transactions	Intermittent (Multiple) Transactions	Total
Number of Customers That Received One (1) Deferred Deposit Transaction	NA	NA	387,338
Number of Customers That Received Two (2) to Five (5) Deferred Deposit Transactions	871,948	416,430	1,288,378
Number of Customers That Received Six (6) to Twelve (12) Deferred Deposit Transactions	305,639	114,160	419,799
Number of Customers That Received Thirteen (13) to Eighteen (18) Deferred Deposit Transactions	78,042	18,764	96,806
Number of Customers That Received Nineteen (19) or More Deferred Deposit Transactions	57,147	17,833	74,980

Discussion of Survey Results

Though the Survey did not use the terms “intermittent” or “continuous” transactions, the results from the survey lead to the conclusion that consumer usage of payday loans can be best characterized as either intermittent or continuous. The definitions used in the survey for multiple transactions and consecutive transactions were designed to assess the number of times customers took a slight break between the time they paid off one payday loan and took out another, and the number of times they effectively paid one loan and took out the next in rapid succession.

As a starting point, we note that for 2006, the data from Table 1-1 show there were 1.4 million consumers who obtained 10 million payday loans in the State. From the survey data we can tell that the 10 million transactions are not evenly spread over the total consumer base. Only 27% of the overall consumer population, or 387,338, engaged in deferred deposit transactions only once, without taking out another for some time. A number of factors may account for this. It could be that these customers are infrequent users of payday loans, relying on the use for unusual situations, perhaps no more than once a year. Another explanation could be that these customers took out one loan earlier in the year, and sequential loans later in the year, due to seasonality of demand for the payday products.

The survey results disclose two important characteristics of payday consumers. First, there is a large bulge in the area of customers who take out two to five transactions. The vast majority of reported payday transactions occur with repeat customers who use the loans between two and five times a year. Second, in that bulge most of customers who use payday loans do so on a continuous basis, as opposed to on an intermittent basis, by almost a two-to-one margin. In other words, customers who take out payday loans from two-to-five times a year appear to take out these loans in fairly rapid succession, engaging in a subsequent payday transaction within five business days of paying off an earlier loan. Nonetheless, a substantial number of customers who use payday loans two-to-five times a year, also do so in more of an intermittent fashion, waiting at least five business days after paying off one loan before taking out another.

The specific data show that of those customers who engaged in two to five transactions, 871,948 were continuous transactions as opposed to 416,430 who were intermittent payday users. Of those customers who engaged in six to twelve transactions, 305,639 engaged in continuous transactions as opposed to 114,160 who exhibited intermittent payday use. Of those customers who engaged in thirteen or more payday loan transactions, 171,786 engaged in continuous transactions as opposed to 36,597 who were intermittent users.

Next, the Department evaluated whether the payday loan product is the appropriate source of credit for consumers in California based on the results of the Survey. In terms of overall costs to consumers, the payday loan product may be appropriate for those customers who limit their use to one deferred deposit transaction and for those customers who engage in two to five payday transactions spread throughout the year. A longer-term, less costly installment loan product may be more appropriate for a substantial category of customers whose use appears more perpetual rather than occasional.

Further analysis of the data in the Annual Report (see Appendix One) and Survey further supports the conclusion that a reasonably priced installment loan product may be more appropriate for a majority of the customers that engaged in deferred deposit transactions in 2006. The Annual Report for 2006 disclosed that the average term and amount for deferred deposit transactions in 2006 was 16 days and \$254, respectively. The average fee charged for the deferred deposit transactions in 2006 can be calculated by using the maximum fee of 15% of the average deferred deposit transaction amount, which is \$38.10 (.15 x \$254 = \$38.10). The maximum fee permitted under the CDDTL is used for this analysis as the regulatory examinations conducted by the Department revealed that almost every licensee charges the maximum fee, with very little fee competition.

This indicates that those customers that received continuous deferred deposit transactions paid an average of \$38.10 every 16 days in order to borrow \$215.90. The following table provides examples of the average fee paid by a customer for deferred deposit transactions in 2006.

Table 2-2
Average Fees

	Average Loan Amount of \$254, Fee of 15%
Average Fee Paid by Customer For One (1) Deferred Deposit Transaction	\$38.10
Average Fee Paid by Customer For Two (2) to Five (5) Deferred Deposit Transactions	\$76.20 - \$190.50
Average Fee Paid by Customer For Six (6) to Twelve (12) Deferred Deposit Transactions	\$228.60 – \$457.20
Average Fee Paid by Customer For Thirteen (13) to Eighteen (18) Deferred Deposit Transactions	\$495.30 – \$685.80
Average Fee Paid by Customer That Received Nineteen (19) or More Deferred Deposit Transactions	\$723.90 +

Those customers that obtained continuous deferred deposit transactions were paying average fees totaling \$76.20 every 32 days with the effect of not reducing the principal balance of the loans. This data indicates that these customers are able to pay off the payday transactions on the due dates, but not meet their expenses without engaging in another deferred deposit transaction. The data further indicates that these customers have the ability to make monthly payments, many for an extended period of time, even when the payments being made represent the equivalent of fees only with no reduction in the principal balance of the deferred deposit transactions.

Table 2-3
Payday Loan Losses

	2005	2006
Total Number of Checks Charged Off (Includes Partial Balances Charged Off)	336,498	307,697
Percentage of Total Number of Checks Charged Off (Including Partial Balances) to Total Number of Deferred Deposit Transactions Made	3.44%	3.06%
Total Dollar Amount of Deferred Deposit Transactions Charged Off (Includes Partial Balances Charged Off)	\$65,216,098	\$74,825,909
Percentage of Total Dollar Amount of Checks Charged Off (Including Partial Balances Charged Off) to Total Dollar Amount of Deferred Deposit Transactions Made	2.63%	2.93%

Losses reported by the industry increased by \$9,609,811, from \$65,216,098 for 2005 to \$74,825,909 for 2006. Despite the increase, losses for the industry as a whole remain low. The percentage of the total dollar amount of loans charged off (including partial balances) to the total dollar amount of loans made was 2.63% and 2.93% for 2005 and 2006.

Using the average deferred deposit transaction amount of \$254 and the maximum fee of 15% (\$38.10), the borrower receives average proceeds of \$215.90. Using these averages, a customer that engaged in six deferred deposit transactions paid fees totaling \$228.60, exceeding the amount advanced by the licensee. Even though the loan losses for the industry are not excessive, an argument could be made that the detrimental impact is mitigated due to the frequency customers' use the deferred deposit transaction in California.

In conclusion, a substantial number of payday loan consumers exhibit behavior suggesting the demand for payday loans in California is self-perpetuating. A longer term, less costly source of credit with monthly payments could be more appropriate for a substantial number of the customers who obtained payday loans in California. The data indicates that a large number of these customers would have the ability to make monthly payments on a reasonably priced installment loan product. These consumers may benefit by having a source of longer-term credit to meet their emergency cash needs that allows them to make affordable monthly payments on a product that amortizes fully within the installment term. The deferred deposit transaction would remain available as a source of short-term credit (31 days) for those borrowers who are able to pay off the full amount of the transaction on the due date.

Unmet Demand Due to Insufficient Loan Limits

Another aspect of demand is whether the loan limit of \$300 in California is sufficient to meet the emergency cash needs of the customers. The industry maintains that the loan limit of \$300 is too low due to the high cost of living in California. One source available to the customers that need to borrow more than \$300 is to obtain additional loans at the same time from different licensees.

To evaluate unmet demand due to insufficient loan limits, the Department obtained a list of all loans made to customers in 2006, including the customer names and loan origination dates, from 23 of the largest licensees. The sample comprised of 1,035,077 customers which is 72.24% of the total customers reported by the industry in 2006 and represented 56% of the total licensed locations. The comparison of the data disclosed that 24,810 customers or 2.4% of the total customers in the sample obtained more than one loan at the same time from different licensees. The results are further broken down in Table 2-4 below.

Table 2-4
Number of Simultaneous Loans from Different Licensees

	2006
Total Number of Customers That Obtained Two (2) Simultaneous Deferred Deposit Transactions From Different Licensees	23,132
Total Number of Customers That Obtained Three (3) Simultaneous Deferred Deposit Transactions From Different Licensees	1,510
Total Number of Customers That Obtained Four (4) Simultaneous Deferred Deposit Transactions From Different Licensees	155
Total Number of Customers That Obtained Five (5) Simultaneous Deferred Deposit Transactions From Different Licensees	13

The majority of the customers obtained two simultaneous deferred deposit transactions, while at least 13 customers obtained five deferred deposit transactions at the same time from different licensees. The Department estimates that these numbers would be substantially greater if the comparative study had included customer data from all of the licensees. This is due in part to the number of smaller licensees that are close to the locations of larger licensees.

In conclusion, the comparison study indicates that the loan amount was not sufficient to meet the emergency credit needs of the borrowers reflected in Table 2-4. This may be due to the loan limit being too low or the licensees not willing to lend the amount needed by the borrower. The supplemental report from AMPG provides insight on the unmet demand and the underlying reasons.

Seasonality of Demand

One final note on demand concerns its seasonality. The Survey the Department sent to its licensees does not capture whether payday loan volume occurs in a linear fashion during the course of the year. The Department notes, however, that one of the largest operators of payday loan stores in California states that its “business is seasonal due to the impact of fluctuating demand for advances and fluctuating collection rates throughout the year. Demand has historically been higher in the third and fourth quarters of each year, corresponding to the back-to-school and holiday seasons, and lowest in the first quarter of each year, corresponding to our customers’ receipt of income tax refunds.” The Annual Report (Form 10-K) of Advance America, Cash Advance Centers, Inc. for Fiscal Year ending December 31, 2006, is available at www.sec.gov.



Chapter 3

Growth and Trends in the Industry

A number of factors affect the industry trends, including market conditions, legislative or regulatory constraints, and developing forms of competition. Though no California specific figures exist prior to 2005, on a national level payday loan volume has increased from \$3.5 billion in 1998 to \$40 billion in 2005 based on information contained in the Annual Report of Ace Cash Express, Inc. for fiscal year 2006.

Industry participants agree on the reasons for this growth.

Growth in these industries [check cashing and payday lending] has been fueled by several demographic and socioeconomic trends, including an overall increase in the population and declining to stagnant growth in household income of lower- and middle-income people. At the same time, closings of less profitable or lower traffic bank branches, primarily in lower-income neighborhoods where the branches have failed to attract a sufficient base of customer deposits, have resulted in fewer convenient alternatives for consumers. These trends have combined to increase demand for the basic financial services [payday lenders and check cashers] provide. Id.

Similarly, the Annual Report for Dollar Financial Corp. for fiscal year ending June 30, 2007, (see www.sec.gov) draws a parallel conclusion.

Despite the demand for basic financial services, access to banks has become more difficult over time for many consumers. Many banks have chosen to close their less profitable or lower-traffic locations and reduced the hours they operate. Typically, these branch closings have occurred in lower-income neighborhoods where the branches have failed to attract a sufficient base of customer deposits.

Other market conditions are prevalent in the industry. Substantial fragmentation of store ownership, for example, exists and is cited in the annual reports of several companies. See, for example, the Annual Report (10-K) of Advance America, Cash Advance Centers, Inc., for fiscal year 2006 ("The payday cash advance services industry is highly fragmented. In March 2006, Stephens, Inc. estimated that there were approximately 23,000 outlets ... in the United States."); the Annual Report (10-K) of Dollar Financial Corp., fiscal year ending June 30, 2007 ("The industry in which we operate is highly fragmented and very competitive. In addition, we believe that the market will become more competitive as the industry consolidates"). The above observation appears to accurately reflect conditions in California. As mentioned earlier, there are approximately 2,500 stores in California and one of the largest operators, Advance America, owned 302 of those stores as of December 31, 2006.

Though there is substantial fragmentation in the industry, in California the top 30 operators of payday stores capture roughly 80% of the transaction volume. In addition, these operators owned approximately 1,500 licensed locations, or about 60% of the number of stores

operating in California, in 2005 and 2006. The top 30 operators reported making 78.5% and 82% of the total dollar volume of payday loans in 2005 and 2006, respectively, and are identified in Table 3-1, below.

Table 3-1
Thirty Largest California Deferred Deposit Transaction Law Licensees 2005 and 2006

Thirty Largest California Deferred Deposit Transaction Law Licensees 2005 and 2006
Ace Cash Express
Advance America, Cash Advance Centers of California, LLC, DBA, Advance America
Allied Cash Advance California, LLC, DBA, Allied Cash Advance
California Check Cashing Stores, Inc.*
California Check Cashing Stores II, Inc.*
California Check Cashing Stores III, Inc.*
Cash 1, LLC
Cash 1, LP*
Cash & Go, Inc., DBA, Cash & Go
Cash America Advance, Inc., DBA, Cash America Payday Advance
Cash America Net of California, LLC**
Cashbak, LLC, DBA, Cashback Payday Advance**
Cash Central of California, LLC, DBA, Cash Central (formerly Direct Financial Solutions of California LLC, DBA, Cash Central)**
Check Agencies of California, Inc., DBA, Check Center
Check Cashiers, Inc., DBA, USA Checks Cashed **
Check Cashiers of Southern California, Inc., DBA, USA Checks Cashed
Check Into Cash, DBA, Check Into Cash
Continental Currency Services, Inc.
Dollarsmart Money Centers, LLC, DBA, Dollar Smart et al.
ER Financial, LLC, DBA, Payday Express
Fast Auto And Payday Loans, Inc.
Fast Cash, Inc.,
Galt Ventures, Inc., DBA, Speedy Cash
GPMM Money Center, Inc., DBA, Dollarmart Money Centers et al.
GVG Financial Services, Inc., DBA, Cash N More**
Jag, CA, LLC, DBA, Advance Til Payday
Monetary Management of California, Inc., DBA, Money Mart
Moneytree, Inc.
Navicert Financial Inc., DBA, Nix Check Cashing/Payday Today
Payday Loan Corporation

QC Financial Services of California, Inc., DBA, California Budget Finance
Southwestern & Pacific Specialty Finance, Inc., DBA, Check 'N Go
Speedy Cash, DBA, Speedy Cash
Virtual E, Inc.
West Coast Cash*

- * One of thirty largest in 2005, not in 2006.
- ** One of thirty largest in 2006, not in 2005.

Increased industry consolidation rests primarily on greater confidence in the stability of the legal and regulatory environments in which these businesses operate. Potentially, such consolidation could benefit consumers since such consolidation would enable industry to gain greater efficiencies and cost savings in their operations. However, passing along the benefits of such efficiencies to consumers, in terms of lower pricing, is not inevitable. Indeed, we note that in California, the Department has observed no real price variability in the amounts charged to consumers. Payday lenders charge the maximum allowed under the CDDTL. Industry consolidation may offer changes in this regard, but that result is not inevitable.

The Department has observed several trends in the industry, including the use of database systems for the collection of payday loan information, the evolution of the traditional bank model, perceived barriers to alternatives to payday loans in California, including the California Finance Lenders Law (CFLL) loans under \$2,500, and cash advance practices of traditional banks and lenders.

Database Systems For The Collection Of Payday Loan Information

Section 23036 of the California Financial Code states in part that:

"A licensee shall not enter into an agreement for a deferred deposit transaction with a customer during the period of time that an earlier written agreement for a deferred deposit transaction for the same customer is in effect."

This provision of this law limits a company's ability to have more than one Payday Loan outstanding with the same customer at any given time. This provision has also been interpreted in certain cases to mean that no customer could have an outstanding loan at more than one licensed location at any given time. This provision would be very difficult to enforce in this state with over 2,500 licensed locations in California that made over 10 million loans in 2006.

States Limiting Number or Amount of Payday Loans		
State	Limits on Number of Loan	Limits on Amount of Loan
Alabama	None	\$500
Alaska	None	\$500
Arizona	1 Loan	None
Arkansas	1 Loan per location	None
California	1 Loan	None
Colorado	1 Loan	None
Florida	1 Loan	None
Hawaii	1 Loan	None
Illinois	2 Loans	None
Indiana	1 Loan per Lender; 2 total	None
Iowa	None	\$500
Kentucky	None	\$500
Michigan	2 Loans or	\$1,200
Minnesota	1 Loan	None
Mississippi	None	\$400
Missouri	None	\$500
Montana	None	\$300
Nebraska	2 Loans	None
North Dakota	None	\$500
Ohio	1 Loan	None
Rhode Island	3 Loans	None
Tennessee	None	\$500
Virginia	None	\$500

Only seven states (AL, FL, OK, IN, IL, ND, MI) have a requirement for a customer database to assist the licensees and the regulator ensure compliance with the limitations on outstanding loans. Five states require that only one database be used within their state and two states allow multiple database systems that provide real time sharing of information.

A database is a system that records all the payday loans made in a state. Normally the law requires a licensee to access a database of all payday loans made to determine if a prospective customer has an existing loan in that state. This allows the licensee to comply with any limitation in that state. The law also requires, in a real time basis, that all loans made are entered into the system when made and an entry must be made when the loan is paid off. The information in the systems is confidential and not subject to any public records requests. Some systems are run and controlled by the state such as Florida. Other databases are owned and operated by third party vendors.

In Florida, the database is owned and controlled by the state but a vendor performs the processing. The vendor collects a one-dollar fee for every transaction and pays the vendor for their services from that fee. Only one database is used statewide. Most states establish the operating requirements for the database systems by regulation. States may or may not be entitled to a portion of the fee collected. The database is the most reasonable method and effective method of determining compliance with any limitations on number or dollar amounts of payday loans.

Databases in all the states that utilize them appear to be operated by vendors. The states establish the requirements for the systems by regulation and in some cases share in the fees collected. The database systems are only accessible by licensees and the state. One vendor, Veritec appears to be the operator in a number of states. The state may or may not be the one contracting with the vendor although it would appear to be more reasonable to have the state as the contracting party to maintain control over the system. The use of some type of database system appears to be the most reasonable method to determine compliance with any loan limitations.

Barriers to Alternatives to Payday Loans in California

In California, other than payday lenders, unsecured personal loans are made by entities licensed under the California Finance Lenders Law (CPLL). Therefore, any person, not licensed as a payday lender, who engages in the business of originating loans not secured by real property is subject to the CPLL (unless otherwise exempt by statute).

Licensees under the CPLL are permitted to make small, unsecured installment loans. In 2006, licensees under the CPLL made 123,498 unsecured loans compared to 10,048,422 made by licensees under the CDDTL. It is likely, due to the rate and fee limitations for loans under \$2,500, that licensees under the CPLL do not offer alternatives to payday loans.

The CPLL limits the rates and fees for loans with a principal balance of less than \$2,500 to an Annual Percentage Rate of approximately 30%. This is compared to the average Annual Percentage Rate of 429% for deferred deposit transactions made in 2006 by licensees under the CDDTL. This by itself is a strong inducement to make small, unsecured loans under the CDDTL as opposed to the CPLL.

In addition, Financial Code Section 22305 of the CPLL prohibits collecting administrative fees that exceed the lesser of 5% of the principal loan amount or \$50 for loans up to \$2,500. Financial Code Section 22305 also states in part "...No administrative fee may be contracted for or received in connection with the refinancing of a loan unless at least one year has elapsed since the receipt of a previous administrative fee paid by the borrower..." Licensees under the CDDTL are allowed to make a new loan on the same date the previous loan was paid off, without any reductions on the fees charged for the second loan.

Financial Code Section 22307(b) of the CFLL states, "...The loan contract shall provide for payment of the aggregate amount contracted to be paid in substantially equal periodical installments, the first of which shall be due not less than 15 days nor more than one month and 15 days from the date the loan is made..." Under the CDDTL, the term of the loan may range from one day to a maximum of 31 days. Many licensees under the CDDTL have the due date of the loan coincide with the borrower's payday. Under the CFLL, the first payment cannot be due less than 15 days from the date of the loan.

As shown in the table below, the majority of the loans made by licensees under the CFLL exceed the principal amount of \$2,500. The average percentage of loans under \$2,500 made from 2004 to 2006 compared to total consumer loans made was 8.4%. Three licensees made approximately 52% of the average 8.4% loans under \$2,500 made by CFLL licensees in the three-year period.

Table 3-2

CFL Number of Unsecured Consumer Loans Made by Year							
	Loan Amount Under \$2,500	Loan Amount \$2,500 - \$4,999	Loan Amount \$5,000 - \$9,999	Loan Amount \$10,000 & Over	Total Number of Unsecured Consumer Loans Made	Total Number of Consumer Loans Made	Percentage of Unsecured Loans Under \$2,500 to Total Loans Made
2006	123,498	117,545	228,037	48,074	517,154	1,508,520	8.2%
2005	175,814	70,381	171,775	36,489	454,459	1,490,407	11.8%
2004	115,566	69,061	131,290	30,916	346,833	2,207,920	5.2%
Average	138,293					1,735,616	8.4%

Alternatives to Payday Loans and their Costs

Interestingly, there exists very little market-based competition for the payday loan product. The Federal Deposit Insurance Corporation (FDIC) has initiated a small dollar loan program for banks it regulates, designed to foster competition by banks for payday loan customers. This program encourages banks to offer consumers a 12-month installment loan at a 36% interest rate that does not renew itself, and perhaps contains a savings component. This project has only recently begun, and insufficient experience exists to assess the viability as a realistic payday alternative.

The Department has observed the growth of peer-to-peer lending programs, usually on-line offerings by companies such as Prosper.com and others. These programs match borrowers

with potential lenders in an on-line auction styled platform. The borrowers indicate the amount of the loan sought along with a range of interest the borrower is willing to pay, and lenders make a bid to fund all or some portion of the loan request. When the full amount of the loan gets bid upon, the transaction is complete. Although this transaction may be quicker than a traditional loan underwriting, it is not as immediate as the payday transaction. In addition, borrower eligibility rests on credit scoring, which is not used in payday transactions. Use of such a minimum credit score may make this avenue unavailable for some number of payday customers.

Consumers in need of immediate funds to meet emergency cash needs, but who do not have access to traditional sources of credit (credit cards, home equity lines of credit, etc.) do have alternatives to payday loans. The following discusses two of those alternatives and the associated costs. Industry representatives maintain that many banks and credit unions offer services that have the same characteristics and costs as payday loans. These include overdraft protection programs and cash advance programs.

An example of a cash advance program is the Direct Deposit Advance Service offered by Wells Fargo Bank that allows a customer to obtain an advance up to \$500 or a lesser limit established for the customer, in \$20 increments. The charge is \$2 dollars for every \$20 advanced. The funds advanced are deposited into the customer's checking account. In order to qualify for the Direct Deposit Advance program, the customer is required to have a recurring electronic direct deposit of \$100 or more from an employer or outside source. The advance must be repaid within 35 calendar days. The advance plus the fee is automatically withdrawn from the borrower's account on the date funds are electronically deposited into the borrower's account. For customers that obtain advances for 12 consecutive statement periods, the credit limit will be reduced by \$100 in each future statement period, until the credit limit reaches zero or an advance is not obtained for one statement period.¹

US Bank also offers a Checking Account Advance product that allows a customer in California to obtain an advance up to \$300 or half the direct deposits made into the account within the most recent statement cycle, in \$20 increments. To be eligible, the checking account must have received a direct deposit of \$100 or more from an employer or outside agency for at least two consecutive statement cycles, one of which must have been received within the last 35 calendar days. The finance charge is one dollar for every ten dollars advanced and must be repaid within 35 calendar days. Payments are automatically deducted from the checking account at the time a direct deposit of \$100 or more is made into the account. A customer that obtains nine consecutive advances will be ineligible for an advance for the next three months.²

¹ Wells Fargo Checking - Direct Deposit Service, 2007

² US Bank – Checking Account Advance, Effective February 2007

The fees and maximum advances for Wells Fargo Bank and US Bank (up to a maximum of 35 calendar days) are compared to the CDDTL (up to a maximum of 31 calendar days) in the table below.

Table 3-3

	Maximum Advance to Customer	Fee Charged for Maximum Advance to Customer	Fee Charged For \$100 Advance to Customer
US Bank	\$300	\$30	\$10
Wells Fargo Bank	\$500	\$50	\$10
CDDTL ³	\$255	\$45	\$17.65

Both Well Fargo Bank and US Bank inform customers that the advances are designed to meet needs for short-term funds and not as a source for longer-term borrowing. Both advise customers to contact the institutions to seek alternative, less expensive credit services for longer-term credit needs.

Bounced check fees are another alternative to payday loans. In 2005, Thomas E. Lehman, PhD. with the Consumer Credit Research Foundation issued a report entitled, *Contrasting Payday Loans to Bounce-Check Fees* that noted that data from the FDIC and the National Credit Union Administration suggest that more than 18,000 financial institutions and credit unions collected \$32.6 billion annually in service charges from 56 million checking accounts. The average checking account is charged \$582 in service fees annually.⁴ Some estimates indicate that banks and credit unions derive 50% or more of their total service fee income from non-sufficient funds fees.⁵ Overdraft fees range from \$20 to \$30 for each non-sufficient funds item. Some depository institutions increase the non-sufficient funds fees if the number of returned items exceeds an established limit in a specified period of time. Almost all banks now charge overdraft fees.

Historically, financial institutions accommodated consumers that did not have a line of credit to protect against overdrafts by paying overdrafts on a discretionary, ad-hoc basis. Whether or not the overdraft was paid, financial institutions imposed a fee referred to as a non-sufficient funds fee. The financial institutions' practice of paying overdrafts has become automated in recent years. This practice was not a concern to regulators as the financial institutions did not advertise or promote the service of paying overdrafts.

³ Under CDDTL, the face amount of the customers check cannot exceed \$300 and the fee cannot exceed 15% of the face amount of the check.

⁴ *Contrasting Payday loans to Bounced-Check Fees*, 2005, Thomas E. Lehman, PhD., Consumer Credit Research Foundation

⁵ *Sizing NSF Related Fees*, January–February 2005, Bill Stoneman, BAI Banking Strategies

The Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and the National Credit Union Administration, (collectively the Agencies) expressed concerns about depository institutions that began marketing “overdraft protection” programs as short-term credit facilities that provided consumers with an express overdraft limit on their accounts. The Agencies noted that while the overdraft protection programs varied among depository institutions and varied over time, the following are some of the common characteristics⁶:

- Depository institutions inform consumers that overdraft protection is a feature of their accounts and promote the use of the service. Depository Institutions may also inform the consumers of their aggregate dollar limit under the overdraft program.
- Coverage is automatic for consumers that meet the financial institution's criteria (for example, the number of days the account has been open and deposits are made regularly). Typically, no credit underwriting is performed.
- Overdrafts are generally paid up to the aggregate limit set by the institutions for the specific class of accounts, typically \$100 to \$500.
- Many program disclosures state that the payment of an overdraft is discretionary on the part of the institution, and may disclaim any legal obligation of the institution to pay any overdraft.
- The service may extend to check transactions as well as other transactions, such as withdrawals at automated teller machines (ATMs), transactions using debit cards, pre-authorized automatic debits from a consumer's account, telephone-initiated funds transfers, and on-line banking transactions.
- A flat fee is charged each time the service is triggered and an overdraft item is paid. Commonly, a fee in the same amount would be charged even if the overdraft item was not paid. A daily fee also may apply for each day the account remains open.
- Some institutions offer closed-end loans to consumers who do not bring their accounts to a positive balance within a specified time period. These repayment plans allow consumers to repay overdraft and fees in installments.

The Agencies expressed concerns regarding marketing, disclosures and implementation of some overdraft programs that met the criteria for short-term credit facilities. For example, the Agencies noted that some depository institutions promoted the service in a manner that led consumers to believe it is a line of credit by informing consumers that their account includes an overdraft protection limit of a specified dollar amount without clearly disclosing the terms and conditions, including how fees reduce overdraft protection dollar limits, and how the service differs from a line of credit. Some depository institutions have adopted practices that appeared to encourage consumers to overdraw their accounts as an advance on their next paycheck, without determining the credit worthiness of the borrower. Some depository

⁶ Joint Guidance on Overdraft Protection Program, February 18, 2005, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation and the National Credit Union Administration

institutions led consumers to believe all overdrafts would be paid, when the payment of an overdraft is discretionary on the part of the depository institution.

The Agencies also expressed concerns regarding use of ATMs and point-of-sale terminals. The Agencies noted that some depository institutions include overdraft protection amounts in the sum they disclose as the consumer's account balance at an ATM, without distinguishing the funds that are available for withdrawal without overdrawing the account. Some depository institutions did not alert the customer at an ATM prior to completion that the transaction would trigger an overdraft fee and allow the customer an opportunity to cancel the transaction.

To address many of these concerns, the Agencies defined overdrafts paid by depository institutions as extensions of credit. Therefore, the Agencies require depository institutions to report overdraft balances as loans on regulatory reports and that overdraft losses be charged off against the allowance for loan losses. The Agencies noted that overdraft programs are required to comply with all applicable federal law and regulations and applicable state laws, including usury and criminal laws, and laws on unfair or deceptive acts or practices. Though many of the requirements and recommendations the Agencies established for depository institutions for overdraft programs are not discussed here, the following that address disclosures, marketing and advertising may be pertinent to this discussion for payday loans:

- Depository institutions should not market overdraft programs in a manner that encourages routine or intentional overdrafts. Instead, the depositor institution should present the program as a service to cover inadvertent consumer overdrafts.
- Fairly represent overdraft protection programs and alternatives when informing consumers about an overdraft program, including other available services and credit products and how those products and services differ (e.g. terms and fees, and how the customer may qualify). Inform consumers of the consequences of extensively using the overdraft protection program.
- Clearly disclose program fees for each overdraft and any interest rate or other fees that will apply. Clearly disclose that more than one overdraft fee may be charged against the account per day, depending on the number of checks presented and other withdrawals from the account.
- Provide election or opt-out service, alert consumers before a transaction triggers any fees, prominently distinguish balances from overdraft protection funds availability and promptly notify consumers each time the overdraft protection program is used.

Since banks and payday lenders share the same customer base, people with checking accounts, banks seem to be a natural source of competition for payday products. Two reasons may exist for the failure of banks to offer such a competitive product. One possible reason has to do with the desire not to cannibalize the banks' own overdraft protection fees by offering a lower cost product that might compete for those overdraft fees. The other possible reason concerns the likely perception that payday loan customers offer no real cross-selling opportunities for other banking fee-based services or products.



Chapter 4

Common Practices for Conducting the Business of Deferred Deposit Transactions

Under the CDDTL, a licensee may defer the deposit of a customer's personal check for up to 31 days, the face amount of the check may not exceed \$300 and the fee may not exceed 15% of the face amount of the check. Licensees are allowed to charge one \$15 Non-Sufficient Funds (NSF) fee. Licensees are prohibited from directly or indirectly charging any additional fees in conjunction with a deferred deposit transaction. Each deferred deposit transaction must be made pursuant to a written agreement.

The Department determined that the electronic equivalent of the customer's personal check is permitted under the CDDTL. This allows licensees, including those that conduct transactions over the Internet, to electronically transfer funds from the borrower's checking account by Automated Clearing House (ACH) or similar electronic means for repayment of the loan on the due date. The borrower is required to provide written authorization for the licensee to debit the borrower's bank account electronically for repayment of the loan.

The Department noted during its examinations that some Agreements included language that gave the licensee the option of depositing a borrower's paper check into the bank or debiting the borrower's bank account electronically for repayment of the loan. Some of these clauses contained authorization to debit the borrower's account electronically for less than the full amount of the loan at any time after the due date, in the event there were not sufficient funds in the account on the due date of the loan. This practice could allow licensees to continually debit a borrower's account for partial balances until the delinquent loan balance is paid in full. It could also allow licensees to continually electronically debit the borrower's account when there are not sufficient funds in the account, resulting in numerous bank charges to the customer. Most banks allow a paper NSF check to be redeposited once, some banks allow a second redeposit of an NSF check.

The Department recommends as a legislative proposal [as set forth in Chapter 6 of this report] to include the electronic equivalent of a personal check in the definition of personal check. This will clarify that licensees are permitted to conduct deferred deposit transaction business over the Internet using ACH transfers and give all customers the flexibility of having funds electronically withdrawn from their account to pay off their loans. To address potential abuses, the Department recommends that licensees be limited to electronically debiting the borrower's account one additional time for the full amount of the loan if there were not sufficient funds in the account on the due date. The borrower must authorize the licensee to make any additional electronic withdrawals from the bank account, specifying the dates and amounts to be debited for collection of the loan.

There is very little fee competition among licensees offering payday loans. Almost all payday lenders charge the maximum fee allowed of 15% of the face amount of the check. Some

reduce the fee slightly for certain loan amounts. For example, if the borrower receives \$100, the maximum fee allowed is \$17.65. Many licensees round the fee down to \$15. Some licensees offer lower fees for the first loan and some licensees pay referral fees to existing customers for bringing in new customers.

Licensees maintain that payday loans are convenient and easy to obtain. Most licensees, at a minimum, require identification, current pay stub, home address, employer's address and checking account information. Licensees rarely conduct a credit check or verify if the borrower has the ability to repay the loan taking into other debts and expenses. Licensees are able to complete transactions quickly, many times in less than 15 minutes.

Most licensees require the borrowers to complete an application for the first loan, only updating the information to reflect changes upon applying for future loans. Licensees may defer the deposit of the customer's personal check for up to 31 days. Though it is not a requirement of the CDDTL, the due date of most payday loans coincide with the borrower's payday. Many licensees limit the terms of loans to 14 or 15 days. Some of these licensees make loans with shorter terms to borrowers that apply for loans less than the 14 or 15 days from their payday, as opposed to making loans with longer terms, from 17 to 31 days. The fees for the shorter-term loans are not reduced, thus resulting in a higher annual percentage rate than a longer-term loan.

The most common method of distributing loan proceeds to the borrowers is currency, though the option of electronically depositing the funds into the customers' bank account is increasing in popularity among licensees. A few licensees only disburse the proceeds by check. At least one licensee loads the proceeds onto a debit card, paying all of the fees associated with the borrower's use of the debit card. In general, the Department has not allowed licensees to use debit cards to distribute proceeds due to the additional fees charged to the customers. Licensees maintain that the use of electronic deposits, checks and debit cards for distributing proceeds to borrowers improve safety as less currency is maintained in the store and the customers are not leaving with cash.

It is a common practice for customers to pay off their loans in currency. Many customers obtain a new loan on the date the previous loan is paid off. This practice makes it difficult to confirm that the loan was in fact paid off and a new loan granted, or only the fee was paid in order to refinance or extend the due date of the loan. The common practice of paying off the loans in currency also makes it difficult to confirm that the customers were not charged unauthorized fees, such as late payment fees, excessive NSF fees and other similar fees.

As part of the Department's Survey, all licensees were required to report the number of payment plans entered into with customers in 2006. A payment plan was counted even if the borrower did not make all of the payments as agreed to in the payment plan. Only one payment plan was counted for a loan with multiple payment plans. For the minimum, maximum and average number of days of payment plans, the number of days was counted from the date the payment plan was entered into with the customer to the last payment date as agreed to in the payment plan. A transaction in which the borrower defaulted on a loan,

then made payments without entering into a payment plan, was not counted. The results of the Survey relating to payment plans consolidated for the industry are disclosed in the following table.

Table 4-1
Payment Plans January 1, 2006 to December 31, 2006

Total Number of Customers That Entered Into Payment Plans For Repayment of Deferred Deposit Transactions	11,094
Total Number of Individual Customers Who Obtained Deferred Deposit Transactions (Repeat Customers Counted Once)	1,432,844
Percentage of Total Number of Customers That Entered Into Payment Plans For Repayment of Deferred Deposit Transactions to Total Number of Individual Customers Who Obtained Deferred Deposit Transactions	.77%
Minimum Number of Days of Payment Plans	1
Maximum Number of Days of Payment Plans.	600
Average Number of Days of Payment Plans.	32

The CDDTL provides that the Agreement may contain a payment plan or an extension, if applicable. The licensee is prohibited from charging late payment fees, fees for extending the due date of the loan or charging additional fees for payment plans. Initially, the Department required written extension and payment plans signed by the borrower. Though the majority of licensees attempted to comply with this requirement for payment plans, enforcement became problematic. For example, licensees asked if they would be prohibited from accepting partial payments from a borrower that refused to come in and sign a payment plan. The Department also found it difficult to distinguish between delinquent loans in collection as opposed to transactions requiring payment plans signed by the borrowers.

Licensees routinely verbally approve requests received from borrowers over the phone to extend the due dates of loans. The Department received two complaints alleging that the licensees verbally extended the due date of the loans over the phone, then deposited the checks prior to the new agreed upon due date. The Department found it difficult to determine if the licensee did in fact receive and approve the verbal request for the extension.

As noted above, the Department initially required that extensions be in writing and signed by the borrowers. The licensees had the option of including the extension in the Agreement or in an addendum to the Agreement executed at a later date. The licensees also expressed concerns about this requirement due to the difficulty in obtaining the customers' signatures on extension agreements. In many cases, the loans were paid off before the licensees could obtain the borrowers' signature on the extension agreements. The licensees noted that the borrowers would be adversely affected if extensions could not be granted if the borrowers do not sign an extension agreement. To address this concern, the Department ceased taking an exception for failure to have extension agreements signed by the borrowers.

Internet Deferred Deposit Transactions

In the Department's Survey, the licensees were asked to report the number of deferred deposit transactions originated and closed over the Internet. These are transactions that have the applications completed online and returned to the licensees with the electronic signatures of the customer over the Internet. In 2006, 16 licensees reported making 116,779 deferred deposit transactions over the Internet. Currently, the CDDTL does not contain specific guidelines and requirements for conducting deferred deposit transactions over the Internet. Therefore, the Department recommends legislation that will provide guidance for conducting deferred deposit transaction business over the Internet, including provisions to ensure that customers are provided all of the required notices and disclosures.

Comparison Of State Regulation

A review of state payday lending laws was conducted and focused on six areas relating to a payday loan. Information was gathered regarding the maximum amount of the loan, length of the loan, rates and fees, the number of loans a borrower may have outstanding at one time, rollovers and cooling off periods. This information was then compared to provisions in the CDDTL.

Eleven states prohibit payday loans and therefore, do not have state laws for these transactions. Of the 39 states that allow payday loans, three states permit payday loans through a small loan act or licensing law and eight states authorize payday lending by check cashers only.

The maximum loan amount is the amount of the borrower's personal check that will be deferred. California limits the amount of the loan to \$300. Six states have no limit on the amount of the loan and the remaining states' limits range from \$300 to \$1000. Over 50% of the states have a maximum loan amount of \$500. Three states reference the borrower's gross monthly income in determining the maximum loan amount; 25% of the borrower's monthly gross income, \$500 but no more than 15% of gross monthly income and \$1,000 or 15% of gross monthly income whichever is less.

The length of the loan is the amount of time the lender will hold the borrower's personal check before submitting it to the financial institution for payment. California allows the check to be held for up to 31 days and does not include a minimum length of time. Four states do not address the length of the loan. Twelve of the 34 remaining states include either a minimum number of days or a range of days with a minimum and a maximum. When a minimum is stated the range is 5 to 14 days and an average of 10 days. The average maximum length of time is 45 days.

The amount of interest and additional fees that can be charged are not specified in seven states. California law states a fee for a deferred deposit transaction shall not exceed 15% of the face amount of the check. A \$300 loan would result in a \$45 fee; therefore, the borrower would receive \$255 in cash when the loan is made. California law also allows a \$15 one-time

return check fee for each loan. Eight additional states charge 15% with one state including a \$30 maximum. Five states include a sliding scale with a 15% maximum rate. Four states allow a percentage greater than 15%. Twenty-five percent is the highest rate and is allowed in only one state. There are also states that use various percentages ranging from 15% to 10% depending on amount of the loan. Three states that allow a 10% rate also allow additional fees to complete the loan process. Three state laws that do not specify an allowable rate or fee but do include a maximum amount the borrower can be charged after default or after renewals.

Debt limits based on the number of loans and the total dollar amounts outstanding are used to limit the amount of the payday loan in 59% of the states. The CDDTL allows only one loan outstanding for each borrower. Six additional states also have a limit of one loan. Twenty-two states have no specified limit on the number of loans, although six of these states have a debt limit ranging from \$500 to \$1,000. Five states limit the number of loans that customers can have outstanding at the same time to two, while two other state limit the number of simultaneous loans to three. Other limits on loans to customers refer to the number allowed per lender or business location.

A rollover refers to an unpaid loan that has come due but the borrower does not have sufficient funds to make payment. The payday lender will allow the loan to "rollover" for another term if a fee is paid. California does not allow rollovers, and similarly 62% percent of the states do not allow rollovers. Most states do not allow a borrower to take out a new loan to pay off an existing loan or repay, refinance or consolidate by proceeds of another check. Those states that do allow renewals also include a limit on the number of renewals, ranging from one to six.

In order to protect borrowers from obtaining numerous payday loans a cooling off period is required in some state laws. The "cooling off period" refers to the time a borrower must wait before taking out a new payday loan. California law does not include a cooling off period, however 82% of the states do not have a cooling off period. The cooling off period for seven states range from one day to seven days and may only apply after a specific number of loans have been made.

In summary:

- California restricts the amount of the loan to a lesser amount than most states, \$300 versus \$500.
- The allowable length of a loan in California is less than the majority of states, 31 days versus 45.
- The maximum fee amount of 15% of the face amount of the check is similar to other states, but unlike some states a sliding scale relating to the loan amount is not used.
- The limit on the number of simultaneous loans in California is more restrictive than the majority of states. California only allows one loan outstanding for each borrower.
- California, like the majority of states, does not allow rollovers.
- Similar to the majority of states, California does not include a cooling off period.

The 2005 and 2006 Consolidated Annual Report on the operation of Deferred Deposit Originators, reports the average loan amount to be \$253 and \$254, respectively. This amount comes close to the \$300 maximum amount. The report also reflects an increase in 2006 of the average number of loans made to each borrower from six to seven. The dollar amount of the loans being made and the number of loans per borrower can be taken into account in considering any change to the maximum loan amount.

The consolidated report indicates the average number of days of deferred deposit transactions has remained fairly constant, 16 days in 2006 and 17 in 2005. The length of time appears to demonstrate a practice of allowing the length of the loan to extend only until the next payday. The constant percent of returned checks to transactions, approximately 7%, and the constant percent of checks charged off to transactions, approximately 3%, for both 2005 and 2006 can be considered if action is taken to make any changes to the payday loan product.



Chapter 5

Advertising Practices of the Industry, including any Violations of Section 23027

The review of advertising during the regulatory examinations disclosed that the most common type of advertising is the use of large signs on the outside of the licensed locations advertising payday loans or cash advances. As the payday loan stores tend to be located in high traffic areas, the signs are easily visible to pedestrians and motorists.

The next most common type of advertising noted during the regulatory examinations were advertisements placed in the yellow pages of phone books. The ads contained in the yellow pages advertise payday loans and other related services and products if offered by the licensee. The ads commonly contain the licensee's name, address and phone number. The licensees do not usually disclose the rates or terms in the yellow page ad, though some include loan amounts.

Licensees advertise in the local Penny Saver, local newspapers/magazines, coupon books and ethnic newspapers. The information contained in the advertisements is similar to the ads placed in the yellow pages and usually do not disclose rates and terms. Licensees utilize flyers and brochures to advertise payday loans. Many licensees make the flyers and brochures available to the public at the payday loan store. Licensees also distribute the flyers and brochures in the local area and through mailings to local residents.

Most licensees do not advertise on radio and television. At least one licensee placed an advertisement on the side of a city bus and another advertised on a billboard. Some licensees have websites that advertise payday loans and some use pop-up advertisements on the Internet.

The most common violation is the failure to disclose in advertising that the licensee is licensed by the Department of Corporations pursuant to the CDDTL. Some licensure disclosures were incomplete, did not include "pursuant to the California Deferred Deposit Transaction Law", contained a different law reference or were abbreviated incorrectly. Some licensure disclosures did not contain the licensee's correct name, as stated in the license. This makes it difficult for the consumer to verify if the person is properly licensed and to determine if the person has been subject to disciplinary action by the Department. Advertisements placed in ethnic newspapers and publications in a language other than English commonly disclosed the licensure disclosure in English.

Very few violations were noted for advertising that was misleading or omitted to include material information necessary to fully understand the nature of the transaction. Advertising that disclosed rates and terms were stated fully and in a manner that would not be misunderstood by prospective customers. In a few isolated instances, licensees advertised payday loans that exceeded the maximum amount of \$300 permitted under the CDDTL.



Chapter 6

Recommendations and Options for Future Actions

Based on the Department's experience administering and enforcing the CDDTL and a review and consideration of information including the demand for this financial product, the Department proposes the following recommendations to improve regulatory oversight of the industry and to establish stronger enforcement tools. The Department has also included various options to address payday loan transactions, for the Legislature's consideration including, but not limited to, options in the following areas: fees charged to consumers; specifications regarding the length of time for deferred deposit transactions; maximum amount provided to consumers; and an installment loan product in lieu of a deferred deposit transaction. The Department continues to be available to assist interested parties in drafting additional measures for efficient and effective administration and enforcement of the CDDTL.

Recommendations to Improve Regulatory Oversight of the Industry

The Department recommends various changes to the law to help protect consumers. These recommendations are intended to improve regulatory oversight by addressing various activities of payday lenders including, but not limited to, advertising and soliciting payday loans, disclosure and execution of payday agreements, Internet and electronic transactions, collection of loans, and other license activities. Unless otherwise noted, the following recommendations would require legislation to add or amend existing statutory provisions because they broaden the scope of existing law.

1. Protect Consumers From Criminal Prosecution

Recommend clarifying and confirming that licensees cannot refer delinquent payday loans to a District Attorney (local prosecutor) for collection of returned checks in conjunction with those loans. Under Financial Code sections 23035(b), (c) and (d), a customer cannot be subject to any criminal penalty for the failure to comply with the terms of the agreement and a licensee must disclose that the customer cannot be prosecuted or threatened with prosecution to collect a payday loan. The above recommendation would help specify that a licensee cannot use the criminal process to collect a returned check in conjunction with a payday loan, even if the customer is not criminally prosecuted.

2. Enhance the Regulation of Electronic Transactions

- a. Recommend clarifying the definition of deferred deposit transaction in Financial Code section 23001 to include, as a personal check, the electronic equivalent (Automated Clearing House or ACH transaction) of the personal check. This recommendation would help provide accountability and oversight of electronic payday loan transactions, and ensure continued application of consumer protections to these loans.

- b. Recommend adding a provision to the CDDTL requiring a licensee to give the borrower an option of having the licensee deposit the customer's personal check or electronically debit the borrower's account for payment of the loan on the due date, if the licensee offers this service. This recommendation would help provide advance notice of this service to the customers so they can make an informed choice.
- c. Recommend allowing a licensee to electronically debit the borrower's account one additional time for the full amount of the loan anytime after the due date without any further authorization from the borrower, if there were not sufficient funds when the account was electronically debited for payment of the loan on the due date. However, any additional electronic debits from the borrower's account must be authorized in writing by the borrower, specifying the dates and amounts of the electronic debits. This recommendation would help protect customers from unanticipated or unknown debits.

3. Improve Disclosures For Consumers

Recommend amending Financial Code Section 23035 to: clarify that the notice provided to the borrower prior to entering into the payday loan agreement must be a separate, distinct document from the written agreement; require that the licensee have the borrower initial a copy of the notice to acknowledge receipt; and require the licensee to retain a copy of the notice with the borrower's initials acknowledging receipt in the file. These changes would help document that a customer received and had an opportunity to review and understand the mandated notice and disclosures.

4. Notify the Regulator About Other Consumer Business

Recommend requiring license applicants and existing licensees (through administrative regulation) to notify the Department of other business that would be or is being conducted at the licensed location. This recommendation would help coordinate oversight of businesses with other agencies and regulatory programs that may have jurisdiction over the other business such as check cashing. Moreover, this recommendation could help detect whether consumers are receiving other products or services in a manner that violates the law. See, for example, Financial Code section 23037(c).

5. Expand Consumer Protections for Internet Transactions

Recommend adding provisions to the CDDTL to address deferred deposit transaction business conducted over the Internet. At a minimum, recommend provisions to do the following: ensure that all required notices and disclosures are provided to the borrower and that the borrower can download the agreement, notices and disclosures and, if the borrower cannot download these documents, then the licensee must mail copies to the borrower within 24 hours; require that the borrower agree to conduct the transaction over the Internet; and provide that deferred deposit transactions conducted over the Internet shall comply with The Electronic Transactions Act (Civil Code Section 1633.1 et. seq.) These changes would help enhance disclosure and oversight of this type of transaction for the protection of consumers.

6. Specify Payment Plan Arrangements

Recommend amending Financial Code section 23036 to require that payment plans entered into between the licensee and the borrower must specify the payment dates and amount of each payment, and must be in writing and signed by the borrower. Also, provide that this requirement shall not prohibit a licensee from accepting payments from a borrower after the due date of the loan without a written payment plan signed by the borrower. This amendment to the law would help borrowers and lenders understand their rights and obligations in connection with payment plans.

7. Clarify Extension Date Obligations

Recommend amending Financial Code section 23036 to require written agreements signed by the borrower for an extension of the loan due date; and provide the licensee with an option to notify the borrower by mail of the approval to extend the due date of the loan, if the borrower elects not to sign the extension agreement. This recommendation would help avoid misunderstandings regarding any extension of time to repay the loan.

8. Disclose Consumer's Repayment Rights

Recommend amending Financial Code Section 23035(e) to require a licensee to prominently disclose that a borrower has the right to request a written extension agreement and payment plan from the licensee. This change would help borrowers understand these available options and could thereby help them address any financial difficulty.

9. Expand Regulation of Payday Loan Advertising

Amend Financial Code section 23027 governing advertising to expressly apply to advertising on the Internet, and require licensees to keep advertising for two years. These changes would help further protect consumers from false advertising on the Internet, and would help ensure availability of advertising records for audit purposes.

10. Provide Consumers With License Information

Recommend amending Financial Code section 23027 to clarify that licensure disclosure in advertising shall be: “[Licensee] is licensed by the Department of Corporations pursuant to the California Deferred Deposit Transaction Law” and consider allowing flexibility to abbreviate California and/or Department. In addition, amend the code to require all disclosures in advertising to be in the same language as the advertising itself. This recommendation would help consumers identify the regulatory agency more quickly at the initial product advertising stage, and help them avoid misunderstandings based on multiple languages.

11. Make Consumer Disclosures Mandatory

Recommend amending Financial Code section 23035(d)(2) to require (not merely allow) a comparison of fees and related information, as specified by law. Existing law requires licensees to post a schedule of all charges and fees, with an example of all charges and fees that would be charged on at least a one-hundred-dollar (\$100) and a two-hundred-dollar (\$200) deferred deposit transaction, payable in 14 days and 30 days, respectively, giving the corresponding annual percentage rate. Existing law provides that the information may be provided in a chart as follows:

Amount Provided	Fee	Amount of Check	14-day APR	30-day APR
\$100	XX	XXX	XXX	XXX
\$200	XX	XXX	XXX	XXX

This recommendation would require that the information be provided in a chart as shown above, to help ensure that consumers have the information to make an informed choice.

12. Increase the Ability to Scrutinize Applicants

Recommend amending the licensing provisions of the CDDTL (and/or the adoption of administrative regulations) to provide the following requirements and procedures for license applicants and applications:

- a. Require license applicants to list each person in charge of a location and require that person to submit fingerprint information and a historical profile through a so-called Statement of Identity and Questionnaire (SIQ). Require the licensee to notify the Department within 10 days of a change in the person responsible for the location and submit fingerprint information and SIQ for the new person.
- b. Require the license application to state that the Department must be notified by filing an amendment to the application at least 60 days prior to a change of its officers, directors or any other persons named in the application. Require the amendment to set forth the change, the effective date of the change, names of persons involved in the change, and fingerprint information and SIQ for each successor person.
- c. Require the applicant and all persons named in the application and SIQ to disclose whether they have conducted a deferred deposit transaction business in any other state and whether they have violated similar regulatory schemes, and require notification of violations on a continuous basis.

The above changes would help detect unscrupulous operators on an ongoing basis and enable the Department to bar bad actors pursuant to its authority under the CDDTL such as Financial Code section 23011.5.

Recommendations to Strengthen Enforcement

The following recommendations would help bolster the enforcement powers of the Department for the protection of consumers and make enforcement actions and remedies more efficient and effective in areas such as administrative orders, civil actions, and criminal prosecutions. Unless otherwise noted, the following recommendations would require legislation to add or amend existing statutory provisions because they broaden the scope of existing enforcement authority under the law.

1. Confirm Jurisdictional Nexus for Enforcement

Recommend amending Financial Code section 23001 to clarify that a payday lender is subject to the CDDTL when it conducts deferred deposit transaction business "in this state" such as when this business originates from this state or is directed to this state, under specified activities. This recommendation would help clarify the application of the CDDTL to payday lenders operating inside or outside the state, and would help confirm the Department's authority to enforce the law against these operators.

2. Bar Applicants Before and After Licensing

Recommend amending Financial Code sections 23011, 23011.5, 23045 and/or 23052 to expand the grounds for barring, suspending, or censuring persons managing or controlling payday lenders such as officers, directors and controlling shareholders; and for denying, suspending or revoking licenses. This expansion of enforcement authority may be based on the following grounds: 1) specified administrative, civil, and criminal acts involving theft, embezzlement, fraud, conversion or misappropriation of property, forgery, bookmaking, receiving stolen property, counterfeiting, extortion, checks, credit cards, and computer violations, 2) violations of rules or orders of the Department or of other regulatory schemes, and actions by other agencies, 3) false statements in records provided to the Department, 4) failures to supervise others in preventing violations of law, and 5) existing court or regulatory orders enjoining further payday business, among other things. In addition, amend section 23045(f) to clarify that a surrender of a license does not affect the licensee's administrative liability in addition to its "civil or criminal liability." These recommendations would help protect consumers from unscrupulous persons with a track record of unlawful activity that may occur before or after licensure.

3. Protect Consumers Through Administrative Orders

Recommend the following: 1) amend Financial Code section 23050 to allow administrative orders for the prevention of unsafe and injurious practices and to make orders effective within 30 days if no hearing is requested, 2) amend Financial Code Section 23053 to allow the Department, through more expedient administrative orders, to suspend or revoke a license for failing to maintain a surety bond as required by law, and 3) amend Financial Code section 23021 to allow the Department to assess a penalty of \$500 by administrative order (rather than a civil action as the case is now) when a licensee does not provide notice of any changed

business location. These changes would help prevent and deter certain violations of law in a more efficient manner.

4. Increase or Add Enforcement Penalties and Costs

Recommend the following: 1) amend Financial Code section 23051(c) to increase civil penalties from \$2,500 to \$10,000 per violation and to provide that administrative penalties of up to \$2,500 per violation may be levied and collected through specified administrative hearing procedures under the Administrative Procedures Act, 2) allow the Commissioner to collect costs including reasonable attorney's fees and related expenses in connection with the administrative or civil action, and 3) amend Financial Code section 23016(b) to increase the penalty for failure to pay the annual licensing assessment from 1% of the assessment for each month or partial month that the payment is withheld to at least 10%.

5. Ensure Available and Accurate Records and Reports

Recommend amending Financial Code section 23024 to do all of the following: 1) require that deferred deposit transaction records be kept for six years (rather than two years which makes it difficult to pursue civil or criminal cases), 2) require licensees to keep and use complete sets of books, records, and accounts of transaction in accordance with good accounting practice, and 3) provide that the failure to keep these records of account is *prima facie* evidence of CDDTL activities. Moreover, amend Financial Code section 23026 to require the annual report to be verified or certified by the licensee or an authorized representative of the licensee under the penalty of perjury. These changes would help provide reliable records, and to better detect violations of law.

6. Compel the Production of Books and Records

Recommend amending Financial Code section 23048 to authorize the Commissioner to subpoena all books and records of the payday lender. Presently, the Commissioner can only require production of books, records and supporting data used by the licensee to "prepare reports" to the Commissioner. In addition, amend section 23048(b) to clarify that the 10 day provision to produce records after a written demand is not in conflict with section 23046 that requires "free access" to the records pursuant to an exam, and 23024 that allows the Department to examine records "at any reasonable time." These amendments would clarify the authority to compel production and enable the Department to better enforce the law and to protect consumers by obtaining access to any books and records and other things in connection with the payday loan business.

7. Expand Equitable Remedies For Consumer Protection

Recommend amending Financial Code section 23051 to allow the following in specified civil actions: 1) appoint a receiver or conservator over the payday lender's assets, 2) require the licensee to take remedial action, and/or provide an accounting or audit or specified financial reports. This recommendation would help prevent any further harm against consumers in appropriate cases.

8. Expedite the Recovery of Enforcement Remedies

Recommend amending the CDDTL to allow the Department to seek a court order to enforce any administrative decision awarding restitution, administrative penalties (other than citations) and recovery of costs without the necessity of filing a civil case and motion for summary judgment. This recommendation would help the Department provide necessary relief in a more efficient manner.

9. Improving the Citation Process To Protect Consumers

Recommend amending Financial Code section 23058 to do the following: 1) provide that a citation is deemed final if the cited lender fails to request a hearing within 30 days of receiving the citation, 2) clarify that the Department may issue a citation for an assessment of an administrative penalty not to exceed \$2,500 per violation (rather than \$2,500 per citation). These amendments would clarify the enforcement of law and provision of remedies in a manner that better protects consumers.

10. Other Remedies Including Void and Forfeited Transactions

Recommend amending Financial Code sections 23060, 23061 and 23062 to clarify that the Department has the authority to order the voiding of loans and the forfeiture of fees. This recommendation would add certainty to the law by expressly addressing whether the Commissioner can void the loans by order, rather than requiring a civil lawsuit. Moreover, consideration should be given to harmonizing certain provisions set forth in these code sections, as necessary and appropriate. As examples: 1) section 23060(a) refers to "charges or fees" and "the principal" whereas section 23060(b) refers to "any amount" and "charges, or fees," 2) Financial Code section 23061(a) refers to "charges permitted" and then "charges and fees," and 3) section 23062(a) refers to "fees on the deferred deposit."

Other Options Regarding Payday Loan Transactions

From a policy perspective, it is important for consumers to have lower cost alternatives to payday loan products. Peer-to-peer lending programs may be promising, but might not be available for consumers whose credit scores are below a certain level. Other competitive alternatives have not developed in the market. And the FDIC small-dollar lending program and payday study are too new to yield any meaningful results.

Financial Code section 23057 asks the Department to address the implementation of an installment contract as an alternative to the payday loan. If such an installment product is made available, the Legislature should consider whether it fully amortizes, and whether it is limited to not more than one at a time for consumers. It is possible for the payday product and the alternative installment product to co-exist alongside another, one for short-term usage, and the other designed for more extended use and repayment.

The following options are based on the premise that the payday loan will be available to meet the short-term emergency cash needs of the consumers, while allowing for a longer-term installment product for those consumers that are not able to pay back the full amount of the payday loan on the due date and have sufficient funds remaining to pay their normal living expenses. These options would require legislation to add or amend statutory provisions in connection with the payday loan product.

In providing these options for further consideration, we believe that policymakers should take precautions to avoid unintended consequences that could drastically reduce or eliminate the availability of a payday loan product that some consumers need or want. Some of the below options may work together, while others could represent alternative courses of action. All would require further study and analysis by interested parties concerning their potential economic impacts.

1. Payday Loan Origination Fee

The payday loan origination fee could constitute a flat fee rather than a percentage of the face value of the check. As an example, for each \$100 borrowed, the consumer could pay no more than \$15 which is an amount added on top of the amount of the loan. In addition, costs could be reduced further if the loan remains outstanding for a full month rather than two weeks. See option number 8, below. Consumers could also be encouraged to repay the amounts earlier where possible, but not in order to take out yet a new payday loan.

2. Maximum Amount of Payday Loan

The current maximum amount of the payday loan could be increased from \$300 to another amount such as \$500 or \$750. In comparison, California's maximum loan amount is less than most other states. For example, most states with payday loan laws have limits of \$500 or more. Also, the current maximum loan amount in California may be too low for meeting emergency cash needs since some borrowers appear to be obtaining payday loans from multiple payday lenders. In addition, the CDDTL could be amended to provide that the face amount of the check shall not exceed that maximum amount plus the fee. Current law limits the maximum amount of the payday loan to \$300, which includes the maximum fee of \$45 (15% of the face amount of the check). Thus, if the maximum fee is charged, the borrower only receives \$255.

3. Adjust Fees Based on Loan Amount

The CDDTL could be amended to provide a maximum fee per each \$100 borrowed. As an example, allow a maximum fee of \$12 for every \$100 up to \$300, and allow a maximum fee of \$10 for every \$100 over \$300. This change in the fee structure may be reasonable if the loan amount is increased and if it is based on fees charged in other states. Some states with payday loan laws have sliding scales based on the amount of the loan, typically with maximum fees ranging from 10 to 15 percent of the loan amount. A sliding scale is also used in another related law in this state, the California Finance Lenders Law. This approach enables lenders to recover more fees based on higher risk, while tempering costs of loans for consumers requiring a higher loan amount.

4. Limit Number of Products

As another option, current law could be amended to clarify that a licensee cannot enter into a deferred deposit transaction with a customer during the period of time that an earlier deferred deposit transaction is in effect for the customer with any licensee (and not just the same lender). Most states with payday loan laws limit the number of loans that can be made to customers in one way or another. Six states (including California) place limits of one loan per customer, and seven others have limits of two or three loans per customer. Still other states limit the number of loans per customer by establishing debt limits based on the number of loans and total dollar amounts outstanding.

5. Restrict Outstanding Loan Periods

Consideration can be given to restricting a customer from having payday loans outstanding from any payday lender for more than three months in the previous 12 months. This would prevent borrowers from utilizing the payday loan as a long-term source of credit. This alternative is also similar to guidance issued by the FDIC in 2005. In issuing its revised guidance to financial institutions, the FDIC noted that when 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.

6. Require The Offering of a Payment Plan

The CDDTL could be amended to require licensees to offer a payment plan with a minimum number of six equal, monthly installment payments to all borrowers that have had continuous (consecutive) loans for three months; and prohibit the licensees from charging the customer any additional fees or interest in connection with the payment plan. This option could further help financially strapped borrowers to pay off the entire outstanding balance in installments over a minimum period of six months without incurring any additional interest or charges.

7. Implement Database to Track Transactions

Consider as an option requiring all licensees to use a uniform database to record all transactions in real time. Allow for the cost of the system to be paid directly from the licensee to the third party operator. The single database to record payday loan transactions would benefit consumers by providing for immediate enforcement of restrictions regarding the number of loans, multiple loans, terms of loans, rollovers, and charges. Although a database has been implemented in seven other states, its benefit would need to be weighed against any additional cost to licensees that, in turn, could be passed along to consumers.

8. Require Checks to Be Deferred for 31 Days

In addition, the CDDTL could be amended to require licensees to defer the deposit of a customer's personal check for 31 days, for all transactions. Under existing law, licensees may make loans with terms from 1 day to 31 days. States that regulate payday loans have varying requirements for loan terms. In those states that provide a stated term, the minimum average is 10 days and the average maximum is 45 days. Establishing a mandatory term of 31 days would reduce the costs of the loan to the consumer and increase the length of time to repay the loan. The consumer benefits would need to be weighed against any fiscal impact on licensees.

9. Make Installment Loan Products Available

The CDDTL could also be amended to allow licensees to make a fully amortizing installment loan. For instance, allow such a loan in an amount of up to \$2,500 and make the minimum term of the loan six months with equal, monthly installment payments with the first payment due not less than 30 days or more than 45 day from the date of the loan. Also, ensure that the borrower is not required to provide the licensee with a check or other method of access to a deposit, savings, or other financial account maintained by the borrower in conjunction with the installment loan. The borrower may voluntarily allow the licensee to electronically debit the borrower's bank account for the monthly installment payments. Finally, amend the California Finance Lenders Law to mirror these provisions if the rates and terms exceed what is currently permitted under that law. This option would allow an alternative source of longer-term credit with monthly installment payments for those borrowers that are not able to pay off the payday loan on the due date.

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Appendix One - CDDTL Consolidated Annual Report for 2005/2006

	2005	2006
Total dollar amount of deferred deposit transactions made	\$2,479,725,858	\$2,553,302,091
Total number of deferred deposit transactions made	9,785,004	10,047,981
Total number of individual customers who obtained deferred deposit transactions (repeat customers counted once)	1,536,600	1,432,740
Average dollar amount of deferred deposit transactions made	\$253	\$254
Minimum dollar amount of deferred deposit transactions made	\$9	\$4
Maximum dollar amount of deferred deposit transactions made	\$1,000*	\$300
Average Annual percentage Rate (APR)	426%	429%
Average number of days of deferred deposit transactions	17	16
Total number of returned checks from deferred deposit transactions	689,540	751,091
Percentage of total number of returned checks to total number of deferred deposit transactions made	7.05%	7.48%
Total dollar amount of returned checks from deferred deposit transactions	\$180,993,630	\$186,023,043
Percentage of total dollar amount of returned checks to total dollar amount of deferred deposit transactions made	7.30%	7.29%
Total number of returned checks from deferred deposit transactions recovered (includes partial recoveries)	493,780	520,752
Percentage of total number of returned checks from deferred deposit transactions recovered (includes partial recoveries) to total number of deferred deposit transactions made	5.05%	5.18%
Total dollar amount of returned checks recovered (includes partial recoveries)	\$107,640,408	\$106,440,669
Percentage of total dollar amount of returned checks recovered (including partial recoveries) to total dollar amount of deferred deposit transactions made	4.34%	4.17%
Total number of checks charged off (includes partial balances charged-off)	336,498	307,697
Percentage of total number of checks charged off (including partial balances) to total number of deferred deposit transactions made	3.44%	3.06%
Total dollar amount of deferred deposit transactions charged off (includes partial balances charged off)	\$65,216,098	\$74,825,909
Percentage of total dollar amount of checks charged off (including partial balances charged off) to total dollar amount of deferred deposit transactions made	2.63%	2.93%

In 2005, 3% of the companies reported a maximum loan amount over \$300 (the maximum allowed under the California Deferred Deposit Transaction Law). The Department of Corporations followed up with those companies that reported making loans greater than \$300 to determine the reasons for the amounts in excess of the limitation.

Appendix Two – Licensee Survey

STATE OF CALIFORNIA -- BUSINESS, TRANSPORTATION AND HOUSING AGENCY

ARNOLD SCHWARZENEGGER, Governor

DEPARTMENT OF CORPORATIONS

California's Investment and Financing Authority



To: COMMISSIONER OF CORPORATIONS, STATE OF CALIFORNIA

SURVEY FOR LICENSEES ENGAGED IN BUSINESS UNDER THE CALIFORNIA DEFERRED DEPOSIT TRANSACTION LAW

From January 1, 2006 to December 31, 2006

Name of Licensee (as shown on the License): -

Business Phone No.: () _____

Multiple Deferred Deposit Transactions (*Refer to instructions for definition.*)

1. The total number of customers that received one (1) deferred deposit transaction:

2. The total number of customers that received two (2) to five (5) deferred deposit transactions (do not count customers that received consecutive deferred deposit transactions):

3. The total number of customers that received six (6) to twelve (12) deferred deposit transactions (do not count customers that received consecutive deferred deposit transactions):

4. The total number of customers that received thirteen to eighteen deferred deposit transactions (do not count customers that received consecutive deferred deposit transactions):

5. The total number of customers that received nineteen or more deferred deposit transactions (do not count customers that received consecutive deferred deposit transactions):

Consecutive Deferred Deposit Transactions (*Refer to instructions for definition.*)

6. The total number of customers that received two (2) consecutive deferred deposit transactions to five (5) consecutive deferred deposit transactions:

7. The total number of customers that received six (6) consecutive deferred deposit transactions to twelve (12) deferred deposit transactions:

8. The total number of customers that received thirteen (13) consecutive deferred deposit transactions to eighteen (18) consecutive deferred deposit transactions:

9. The total number of customers that received nineteen (19) or more consecutive deferred deposit transactions:

Payment Plans (*Refer to instructions for definition.*)

10. The total number of customers that entered into payment plans for repayment of deferred deposit transactions:

11. The minimum number of days of the payment plans:

12. The maximum number of days of the payment plans:

13. The average number of days of payment plans:

Internet Transactions (*Refer to instructions for definition,*)

14. Did your company originate and close deferred deposit transactions over the Internet? Yes No
15. If yes, list the total number of deferred deposit transactions originated and closed over the Internet.

VERIFICATION

I, the undersigned state: That I am an officer or general partner or the sole proprietor or have a position of similar proprietary interest of (Insert name as shown on the license)

and I have read and signed the Survey and the documents filed herewith and know the contents thereof. I certify that this Survey is to the best of my knowledge true and exact.

I certify (or declare) under the penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Date _____,
(Month/Day) _____ (Year) _____

(Signature of Declarant)

Executed at _____

(Name and Title (Please type or print))

**INSTRUCTIONS FOR COMPLETING THE SURVEY FOR DEFERRED DEPOSIT ORIGINATORS
LICENSED UNDER THE
CALIFORNIA DEFERRED DEPOSIT TRANSACTION LAW**

REQUIREMENT FOR THE SURVEY: On December 1, 2007, the California Corporations Commissioner (Commissioner) is required to report to the Governor and the Legislature on the implementation of the California Deferred Deposit Transaction Law (CDDTL). The report to the Legislature is required to include, at a minimum, information regarding the demand for deferred deposit transactions, the growth and trends in the industry, common practices for conducting the business of deferred deposit transactions, the advertising practices of the industry, including any violations of Section 23027, and any other information the Commissioner deems necessary to inform the Governor and the Legislature regarding potential legislation that may be necessary to protect the people of the State of California. ***Section 23057 of the California Financial Code requires the licensees to supply all information the Commissioner deems necessary to conduct this study.***

The survey is necessary to provide the Commissioner with information on the borrowers' usage of the loan product, specifically if the loans are being used to meet short- term emergency cash needs or the loans are a source of longer-term borrowing. The survey will also provide information relating to the frequency and usage of payment plans. This information will assist the Commissioner in determining if there is a need to recommend changes for the fees charged to consumers, the length of time for deferred deposit transactions, maximum amount provided to consumers, and the implementation of an installment loan product in lieu of or in addition to a deferred deposit transaction. The survey is also requesting information on the volume of deferred deposit transactions conducted over the Internet. This will assist the Commissioner in determining if there is a need to make recommendations for deferred deposit business conducted over the Internet.

WHO MUST FILE THE SURVEY: Every licensee who is licensed as of December 31, 2006 shall file the Department's Survey, unless an exemption has been granted. The Survey is to include information on all business conducted pursuant to the authority of the California Deferred Deposit Transaction Law by licensees located in or outside the State of California. A survey shall be filed even if no business was conducted under the authority of the license during the period from January 1, 2006 to December 31, 2006.

DUE DATE/PENALTY FOR FAILURE TO FILE THE SURVEY: The report is due on or before March 15, 2007, unless an exemption has been granted. No extension of the filing date can be granted. Failure to file the report may result in revocation of your license(s).

WHERE TO FILE THE SURVEY:

DEPARTMENT OF CORPORATIONS
Financial Services Division
320 West Fourth Street, Suite 750
Los Angeles, CA 90013

THE SURVEY FORM: The survey must be submitted on this form.

PERIOD COVERED BY THE SURVEY: The reporting period is (1) January 1, 2006 to December 31, 2006 or (2) from the effective date of licensure for licenses issued after January 1, 2006 to December 31, 2006, unless an exemption has been granted.

COMPANIES WITH MULTIPLE LOCATIONS: Companies with multiple licenses must prepare one survey consolidating the information from all locations into one report.

SURVEY AVAILABLE ON THE INTERNET: The survey is also available at the Department's Internet website at www.corp.ca.gov.

EXEMPTION: Those licensees that can demonstrate that providing the information requested in the Survey for the period from January 1, 2006 to December 31, 2006 will create a substantial financial burden may request an exemption from the Commissioner. The request for the exemption must be in writing and describe in detail the additional costs the licensee would incur in order to provide the information requested in the survey for the period from January 1, 2006 to December 31, 2006. ***The request for the exemption must be filed with the Department no later than January 31, 2007.*** The Department will notify those licensees in writing if the exemption has been granted or not granted. Those licensees that are granted the exemption will be required to file the Survey for the period from January 1, 2007 to June 30, 2007. For those licensees granted the exemption, the survey for the period from January 1, 2007 to June 30, 2007 shall be due on July 31, 2007.

Those licensees that do not submit the request for the exemption by January 31, 2007 or are not granted the exemption shall be required to file the Survey for the period from January 1, 2006 to December 31, 2006 by the due date of March 15, 2007.

VERIFICATION: The Verification on page 3 must be executed by the licensee or authorized person on behalf of the licensee. For example, the verification must be signed by an individual if the licensee is an individual, by a general partner if the licensee is a partnership, by a corporate officer if the licensee is a corporation or a manager if the licensee is a limited liability company. The Verification must have an original signature. Surveys bearing incomplete verifications or a missing signature will not be accepted and will be returned to the licensee.

OTHER REPORT REQUIREMENTS:

Multiple Deferred Deposit Transactions

- The “multiple deferred deposit transactions” shall be the total number of deferred deposit transactions (DDTs) in which an individual borrower obtained a new DDT more than six (6) calendar days after the original due date of the existing DDT. Count those DDTs in which the due date was extended for more than five (5) days from the original due date and those DDTs that had a payment plan with a term longer than five (5) calendar days from the original due date of the loan. Do not count consecutive deferred deposit transactions as described below.

Consecutive Deferred Deposit Transactions

- The “consecutive deferred deposit transactions” shall be the total number of (DDTs) in which an individual borrower obtained a new DDT within five (5) calendar days of the original due date of the existing DDT. Do not count those DDTs in which the due date was extended for more than five (5) calendar days from the original due date or those DDTs that had a payment plan with a term longer than five (5) calendar days from the original due date of the DDT.
- For the “total number of individual customers”, count repeat customers more than once. For example, a customer that received three (3) consecutive DDTs and then six (6) or more calendar days later, received six (6) consecutive DDTs, would be counted once in Item 1 and once in Item 2. A customer that received three (3) consecutive DDTs and then six (6) or more calendar days later, received three (3) consecutive DDTs, would be counted twice in Item 1.

Payment Plans

- For payment plans, list the total number of payment plans entered into with customers. Count the payment plans in which the borrowers agreed to make two or more payments. Count the payment plans even if the borrowers did not make all of the payments as agreed to in the payment plan. Count only one payment plan for each loan, even if multiple payment plans were entered into for the same loan. For the minimum, maximum and average number of days of payment plans, count the number of days starting from the date the payment plan was entered into with the customer to the date of the last payment date as agreed to in the payment plan. Do not count as a payment plan a transaction in which the borrower defaulted on a loan, then made payments without entering into a payment plan with the licensee.

Internet Transactions

- Answer "yes" if your company conducts deferred deposit transaction business over the Internet. Count only those deferred deposit transactions in which the application is completed online and returned to the licensee with an electronic signature over the Internet. If yes, count the number of deferred deposit transactions conducted over the Internet.

QUESTIONS REGARDING THIS SURVEY: If you have questions regarding this survey, you may contact Special Administrator Steven C. Thompson in the Los Angeles office at (213) 576-7610.

Appendix Three - Bibliography

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[End of Report]

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