

BILL ANALYSIS

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S.B. 253
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Current law defines a credit services organization (CSO) and permits such organizations to receive payment for the service of obtaining an extension of consumer credit for a consumer. Texas law governing CSOs was originally adopted in 1987. The intent, according to the House Research Organization bill analysis, was "consumer protection legislation that would address the problem of certain credit-repair services taking advantage of consumers."

Though intended as a consumer protection measure to address problems with credit-repair services, the laws governing CSOs are currently being used by payday, auto title, and other consumer loan businesses to obtain extensions of consumer credit for consumers. According to the secretary of state, there were 3374 registered CSO locations in Texas as of October of 2010. By operating under the CSO laws, these businesses can avoid the rate and fee caps that govern consumer loans under Chapter 342 (Consumer Loans), Finance Code, under which all other lenders function. Using the CSO model, these businesses obtain loans for customers through third-party lenders. The lenders often provide the loan at 10 percent interest, the statutory limit on loans made by unlicensed lenders. The CSOs then charge the customer a fee to arrange and to guarantee the loan. Typically, the fee ranges from \$20 to \$30 for each \$100 borrowed and customers must pay these fees every loan period, usually every two weeks to one month, until the loan is paid off in full. These loan charges amount to an annual percentage rate that often exceeds 500 percent, and the recurring high fees can cause a mounting cycle of debt.

The activities and fees of CSOs are not regulated by the state through licensing or agency oversight, which prevents the ability of the state to collect consumer data or properly investigate and respond to complaints. Federal legislation is already in place to restrict short-term payday and car title loans for active military personnel; however, as payday and auto title loan businesses are operating as credit services organizations, the Texas state agency that oversees consumer lending does not have the authority to ensure compliance with the federal law.

This business model was challenged in federal court, alleging usurious interest rates. In 2004, the United State Fifth Circuit Court of Appeals ruled in *Lovick v. Ritemoney Ltd.* 378 F.3d 433 (5th Cir. Tex. 2004), that the fees charged by CSOs in connection with obtaining an extension of consumer credit for a consumer do not constitute usury, because neither the Credit Services Organization Act (CSOA) nor other provisions in the Texas Finance Code expressly attribute the fees charged by CSOs to the loan interest rate for usury purposes.

S.B. 253 seeks to reverse the effect of the Fifth Circuit ruling in *Lovick v. Ritemoney Ltd.* and to clarify that lenders providing extensions of consumer credit cannot evade Texas usury laws by simply using loan brokers or brokers registered under CSOA. It amends Chapter 302 (Interest Rates), Finance Code, to expressly prohibit third-party fees for arranging or guaranteeing consumer credit and deems those fees as interest for usury purposes. It also prohibits a CSO from obtaining an extension of consumer credit for a consumer. These measures respect the intent of usury limits in state law, promote financial stability for families, and ensure a fair playing field for consumer lenders in Texas.

As proposed, S.B. 253 amends current law relating to the regulation of activities with respect to certain extensions of consumer credit.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Subchapter A, Chapter 302, Finance Code, by adding Section 302.003, as follows:

Sec. 302.003. PROHIBITION ON THIRD-PARTY FEES TO ARRANGE OR GUARANTEE CERTAIN EXTENSIONS OF CONSUMER CREDIT. (a) Prohibits a fee paid or to be paid to a third party to assist a consumer in the transacting, arranging, guaranteeing, or negotiating of an extension of credit from being contracted for, charged, or received by a creditor or third party in connection with the extension of credit if the extension of credit is secured by a non-purchase money security interest in personal property or is unsecured, and the proceeds of the extension of credit are used for personal, family, or household purposes.

(b) Provides that the amount of a fee contracted for, charged, or received in violation of Subsection (a) is considered interest for usury purposes under state law.

SECTION 2. Amends Section 393.001(3), Finance Code, by redefining "credit services organization."

SECTION 3. Amends Subchapter D, Chapter 393, Finance Code, by adding Section 393.308, as follows:

Sec. 393.308. OBTAINING EXTENSIONS OF CONSUMER CREDIT PROHIBITED. Prohibits a credit services organization from obtaining an extension of consumer credit for a consumer or assisting a consumer in obtaining an extension of consumer credit.

SECTION 4. Effective date: September 1, 2011.