Policy Brief:
Bill Analysis of Indiana SB 613: Consumer Credit

Diane Standaert, Director of State Policy, CRL
Carolyn Carter, Deputy Director, NCLC

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SB 613 increases the rates for existing consumer loans in Indiana, adds additional high-cost loan products to the marketplace, and significantly increases the rates that are considered to be criminal loan sharking. For each of these changes, lenders are provided extraordinary leverage over the borrower, are able to structure the loans in a way that incentivizes repeat re-borrowing, and are not required to ensure that the loans are affordable in light of a borrower's income and expenses. This combination of incredibly high-cost loans without any sufficient protections against the harms of unaffordable loans places consumers at significant risk of debt which is designed to be nearly inescapable.

Characteristics of Loan Products Allowed under SB 613

Product	Exceeds Current Loansharking Cap	Incentivizes Repeat Re-borrowing	Takes Leverage over Borrower	Assesses Ability to Repay
Consumer Loan	Yes	Yes	Yes	No
Small Dollar Loan	Yes	Yes	Yes	No
Short-Term Payday Loans	Yes	Yes	Yes	No
Long-Term Payday Loans	Yes	Yes	Yes	No

Authorizes High Costs That Exceed Military Lending Act

Not one of the loans authorized by SB 613 may lawfully be made to active duty members of the military. In 2006, the U.S. Department of Defense (DoD) found high-cost payday loans and installment loans to be so dangerous to active duty soldiers that it determined that these loans undermine military readiness. As a result, Congress—with bipartisan support, and in accord with a DoD recommendation—enacted the Military Lending Act, which caps rates at 36%, inclusive of all fees and charges. Each of the rates authorized by SB 613 violates this standard. While these loans are considered too dangerous to make to active duty soldiers, if SB 613 becomes law, high-cost lenders would be able to make them to Indiana's veterans and any other Hoosier.

Increases Rates for Criminal Loansharking

SB 613 dramatically weakens the state's criminal loan sharking law. Indiana has a long-standing criminal loansharking rate of no more than 72% APR, with which all lenders other than payday lenders must comply. SB 613 allows lenders to make loans that would violate the state's current criminal loansharking law, increases the allowable rates for what is considered criminal loansharking, and exempts a new set of fees from the cap, thus making the law no protection at all against high-cost lending.

Creates Labyrinth of Debt Trap Loans

SB 613 increases the costs of loans in three areas of Indiana's law: consumer loans, small loans, and a new section for a new Small Dollar Loan product, in addition to weakening Indiana's criminal loansharking law. Each of these provisions alone creates an unaffordable debt trap for borrowers, with loans structured to incentivize repeat lending and give lenders extreme leverage over the borrower such as through bank account access or taking their car or personal property as security. Taken together, SB 613 creates a labyrinth of debt trap loans in Indiana's financial landscape, making it nearly impossible for Hoosiers to escape from high-cost debt.

Consumer Loans

Under current law, Chapter 3 of Indiana's Uniform Consumer Credit Code allows lenders to make consumer loans with interest rates up to 36% for smaller loans, and significantly lower interest rates for larger loans.[1] In addition to the interest, a consumer loan can include a $50 origination fee (termed a nonrefundable prepaid finance charge), plus fees for ancillary products such as credit insurance.[2]

All of these costs combine to create large expensive loans, with no requirement that the loans be affordable, and typically lead to multiple refinances. In this segment of the market, over 60% of loans are renewals of existing loans.[3] For example, the lender OneMain notes to its investors: *"Renewals historically have been, and OneMain believes that they will continue to be, an important component of OneMain's business plan with respect to personal loans and as such OneMain expects that a substantial portion of the Loans will be renewed after the Closing Date."*[4]

SB 613 will make matters much worse by increasing costs and incentives for refinancing. The bill not only increases the allowable interest rates, but also triples the nonrefundable prepaid finance charge from $50 to $150.[5] With these changes to Chapter 3, Indiana would allow higher rates than those permitted in 75% of all other states for a $2,000, two-year loan.[6]

Increases of Consumer Loan Costs under SB 613

Example Loans	Cost Under Current Law		Cost Under SB 613	
	APR	Total Charges	APR	Total Charges
$500, 6-mo. loan	71%	$109.18	138%	$219.99
$1,000 1-yr. loan	46%	$265.81	65%	$386.39
$2,000 2-yr. loan	39%	$905.18	44%	$1046.67
$5,000 3-yr. loan	30%	$2,620.86	38%	$3492.24
$10,000 5-yr. loan	25%	$6,872.14	37%	$12,005.44

By increasing the amount of the nonrefundable prepaid finance charges, SB 613 would increase lenders' economic incentive to repeatedly refinance a borrower, prolonging the debt and charging a new set of fees each time. The refinancing of these loans increases the costs to borrowers and makes it much more difficult for a borrower to ever climb out of the debt. Additionally, lenders are not required in any case to refund any of the prepaid finance charge upon early prepayment of the loan, and loan charges are pre-computed at the loan's outset, thus operating as a very high cost prepayment penalty to the borrower.

Under SB 613, if a lender refinances the loan as little as 61 days after the loan origination, it could charge the fees and charges anew.[7] While the bill ostensibly appears to provide a protection against multiple refinance charges by limiting it to two "if the new loans are used to pay a previous loan from the lender," this does not prevent back-to-back transactions in which a lender opens up a new loan shortly after a borrower repays an old loan.[8] The lack of protections against back-to-back high-cost loans could lead to devastating consequences for borrowers, leaving them indebted all year long.

- **Scenario One**: If a borrower repays a $500, 6-month loan on day 61, a lender could make her a new one the very next day carrying a new $150 fee. This could happen up to five times a year, thus causing a borrower to pay over $750 in fees to essentially float that same $500 loan—on top of 36% interest.

- **Scenario Two**: Because there is no minimum loan term required, lenders could replicate two-week short-term balloon loans under this chapter, and would have an even greater incentive to do so in light of the permissible $150 nonrefundable prepaid finance charge. For example, a lender could keep a borrower trapped in a series of back-to-back two-week $300 loans carrying the $150 fee each time – all year long. These would have even higher APRs than the payday loans that currently exist in Indiana, and even fewer protections.

Lenders can take collateral such as cars and personal property as collateral for Chapter 3 loans.[9] For some lenders in this market, such as OneMain, almost 50% of their loans use people's cars and trucks as collateral.[10] This gives the lender a powerful threat of repossession of what is often a person's most valuable or largest asset in order to ensure repayment of the loan or induce the borrower to refinance an unaffordable loan, again and again.

The fees and charges collected from the increases under this section of SB 613 will flow to a wide range of lenders, including not only storefront financial services companies, but also a variety of online lenders already licensed under this section of the Code.[11] They will also flow to the investors of the loans these lenders are bundling and selling back to Wall Street as asset-backed securities.

Long-Term Payday Loans

SB 613 would also make changes to Chapter 7, the state's "Small Loan Law" which regulates payday loans. In these changes, SB 613 does nothing to rein in the costs of payday loans' existing 391% APR interest rates in the state, but instead adds another payday loan product to the mix. The bill refers to this new product as "Unsecured Consumer Installment Loans," but in reality it is a longer, larger type of payday loan that can also carry triple-digit interest rates.[12] For both types of payday loans under SB 613, the payday lender is able to gain direct access to a borrower's bank account either through post-dated checks or electronic debit authorization. Again, both types of loans, like all the other loans in the bill, are structured to keep borrowers in a unending cycle of debt.

Payday Loans Permitted Under SB 613

Example Loans	Existing Short-Term Payday Loans		New Long-Term Payday Loans	
	APR*	Total Repayment	APR**	Total Repayment
$250	**391%**	**$287**		
$500	**349%**	**$567**		
$605			**192%**	**$986**
$900			**186%**	**$1,444**
$1,500			**180%**	**$2,377**

*Calculated using two-week loan term **Calculated using 6-month loan term

The harms of short-term payday loans and their resulting debt cycle are well-documented in Indiana. Payday lenders in Indiana drain over $70 million a year in fees on loans that average $317 in amount.[13] The overwhelming bulk of these fees comes from repeat borrowing. In Indiana, 60% of payday loans are taken out on the same day as the previous loan is paid.[14] These high-cost loans, marketed as a quick financial fix, send people into a spiral that deepens rather than solves their financial crisis. Payday loans are associated with increased likelihood of delinquency on other bills, bank penalty fees, aggressive debt collection, and even bankruptcy.[15]

Payday lenders claim that longer-term payday loans provide a safer, cheaper option than short-term balloon payment loans. The experiences of other states, however, show that is certainly not the case, even when only the longer-term loans exist in the market and with smaller sizes than permitted under SB 613. For example, in Colorado, until voters passed a 2018 ballot initiative to impose a 36% rate cap, long-term payday loans carried a maximum 214% APR and could not exceed $500. Unlike SB 613, the fees in Colorado were not fully earned upon origination. Colorado borrowers still experienced significant distress under the burden of these unaffordable loans: nearly one in four loans went into default or delinquency.[16] Even when the loan payments are actually paid (because the lender has direct access to the borrower's bank account), borrowers described how these loans compounded their already unmanageable debt burdens.[17] In short, these long-term payday loans lead to the same harms as their their short-term counterparts.

Finally, the bill includes a number of provisions that do nothing to stop these harms. These provisions include:

- **Allowing loan payments to reach up to 20% of a borrower's gross monthly income**: This type of provision allows for loan payments to consume a significant part of a borrower's budget, while providing no assurance of affordability. For a typical payday loan borrower earning $22,500 a year, the monthly loan payment could be as high as $375—a huge bite out of a monthly *gross* of just $1,875. Without assessing a borrower's expenses or other obligations – even such as the other loans authorized under SB 613 – it is not possible for a lender to know if the loan is in fact affordable.
- **Insufficient "cooling-off" period**: After two consecutive long-term payday loans, the bill provides a seven-day "cooling off" period. Even with this provision, a borrower could be stuck in two 12-month loans, each with a 167% APR, before triggering this seven-day "break." A seven-day period is insufficient to recover from two years of unaffordable debt. Indiana's current law contains a seven-day cooling off period after the sixth short-term payday loan. Even so, nearly 70% of all payday loans in the state are made within days of the previous loan.[18]

Small Dollar Loans

SB 613 adds new Chapter 8 to the Code to create a yet another new breed of high-cost loans that increases the chance that borrowers will be sunk in unaffordable debt. SB 613 refers to these loans as "Small Dollar Loans," but in reality they are yet another high-cost installment loan product that allows lenders to have extraordinary leverage over the borrower, for example by allowing the lender to take access to a borrower's bank account or even car title. Like the other loans, SB 613 does not provide any requirement that loans must be affordable in light of a borrower's income and expenses, and it creates a fee structure that provides an economic incentive for the lender to repeatedly flip borrowers into new loans well before the original loan term is completed.

The loans in this section come with a complicated and confusing set of high-cost fees, which like the other loans in the bill, are structured to incentivize lenders' repeat refinancing of the loans. The set of fees authorized in this section include:

- 99% rate;
- Nonrefundable prepaid finance charge of $100 to $150 that is fully earned upon origination of the loan; and
- Monthly installment account handling charge of an unspecified amount.

The bill language is so ambiguous in parts that it is unclear which, if any of these costs, are included in the 99% rate. Even assuming a conservative interpretation that all of these costs must come under the 99% rate, this provision alone authorizes incredibly expensive loans.

These concerns are not hypothetical. One lender in this market, Security Finance, has a well-documented pattern of repeatedly flipping borrowers from one unaffordable loan to the next. For example, in Oklahoma, Security Finance flipped a loan 37 times over the course of four years to a mentally disabled man who had fallen into homelessness. In Texas, Security Finance flipped a $200 loan 16 times to a 66-year old widow living on Social Security. In Colorado, the Attorney General found, in a case against Security Finance, that repeated refinances were accomplished by "underwriting practices that place consumers into loans and refinances they have no reasonable probability of repaying."

Finally, SB 613 also allows lenders making Small Dollar Loans to assess other charges permitted elsewhere under existing Indiana law such as for ancillary credit insurance products that have a well-documented history of increasing the cost of the loan to the borrower, providing very little benefit to the borrower, and at the same time increasing the economic incentive for lenders to flip borrowers into new loans.

[1] IC 24-4.5-2-201(2)
[2] IC 24-4.5-2-201(5) and IC 24-4.5-3-202(2)
[3] See, e.g., North Carolina Commissioner on Banks, "Consumer Finance Annual Report," 2017, http://www.nccob.org/public/docs/Financial%20Institutions/Consumer%20Finance/2017CFSAnnualReport.pdf
[4] OneMain Private Placement Memo (2017-1), page 25
[5] IC 24-4.5-3-201(6)
[6] Only 12 states—AL, AZ, DE, ID, IL, MO, ND, NM, NV, SC, TN & UT—would allow higher rates if SB 613 became law. The picture is even starker when considering the $2000 2-year loan allowed by Chapter 8 in SB 613, which would allows an APR of at least 99% for such a loan. With this, Indiana would be worse than all but 9 states – AL, DE, ID, MO, ND, NM, SC, UT, & WI. National Consumer Law Center, "Predatory Installment Lending in 2017: States Battle to Restrain High-Cost Loans," 2017, available at http://www.nclc.org/issues/predatory-installment-lending-2017.html
[7] IC 24-4.5-3-201 (8)
[8] IC 24-4.5-3-201 (8)(a)
[9] By contrast, for retail installment sales IC 24-4.5-2-407 and 24-4.5-2-408 restrict security interests to the items sold in the current or prior sale. If the debt secured is $1500 or more, the security interest may also extend to goods in which the items sold are installed, and if the debt is $4000 or more it may extend to land to which the goods are affixed.
[10] OneMainFinancial Investor Presentation, "ABS East," Sept. 2018, Page 3, http://investor.onemainfinancial.com/Cache/1001245727.PDF?O=PDF&T=&Y=&D=&FID=1001245727&iid=4405478
[11] According to the Indiana Department of Financial Institutions licensee list, online lenders licensed under Chapter 3 include LendingClub, Avant, and Oportun.
[12] Proposed IC 24-4.5-7-201.5 in SB 613 provides the permissible charges for the longer-term payday loans.
[13] See generally, Indiana Institute for Working Families, "Payday Loans Fact Sheet," http://incap.org/iiwf/documents/Paydaylendingfactsheet1-draft7.pdf
[14] See Consumer Financial Protection Bureau, *Supplemental Findings on Payday, Payday Installment, and Vehicle Title Loans, and Deposit Advance Products*, 2016, https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf
[15] Center for Responsible Lending, *State of Lending: Payday Lending Abuses and Predatory Lending Practices*, 2013, http://www.responsiblelending.org/state-of-lending/reports/10-Payday-Loans.pdf
[16] State of Colorado, Department of Law, 2016 Deferred Deposit/Payday Lenders Annual Report, available at https://coag.gov/sites/default/files/contentuploads/cp/ConsumerCreditUnit/UCCC/AnnualReportComposites/201 6_ddl_composite.pdf. The Colorado Attorney General publishes Annual Reports based on data submitted annually by all licensed payday lenders operating in the state. All Annual Reports issued by the Attorney General since 2011 can be found at https://coag.gov/uccc/info.
[17] Center for Responsible Lending, *Sinking Feeling: Colorado Borrowers Describe their Experiences with Payday Loans,* 2018, https://www.responsiblelending.org/research-publication/sinking-feeling-colorado-borrowers-describe-their-experiences-payday-loans.
[18] See Consumer Financial Protection Bureau, *Supplemental Findings on Payday, Payday Installment, and Vehicle Title Loans, and Deposit Advance Products*, 2016, https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Supplemental_Report_060116.pdf