Question of the Month: A review of laws in Midwest regulating short-term lending industry

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The November Question of the Month provides a brief overview of state laws in the Midwest regulating the short-term lending industry.

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Question: What regulations have been placed on the short-term lending industry in the Midwestern states?

Answer: State legal restrictions on the short-term loan industry have included:

- Capping the interest rates applied to loans,
- Restricting the areas in which loan stores can locate;
- capping the maximum loan amount allowed; and
- Limiting the number of times a loan can be “rolled over” or renewed for additional time to pay it back.

The most popular form of short-term lending is payday lending, which provides small loans (typically for a term of a couple of weeks) to help borrowers through a temporary cash-flow problem until their next payday. The loans generally range from $100 to $500, and can carry very high interest rates or fees.

Despite the growing list of states regulating the industry, the Center for Responsible Lending [3] reports that the average payday-loan borrower has nine repeat loans each year, is typically charged $50 each time a loan is rolled over and pays a 400 percent annual interest rate on a typical loan.

According to the Consumer Federation of America [4], one way to protect consumers is to limit the finance charge applied to these loans. A cap of 36 percent on the annual interest rate is the benchmark often used by consumer groups.

Ohio is the only state in the region to cap payday-loan rates below this 36 percent threshold. With a 28 percent rate cap, Ohio’s restrictions are among the most stringent in the nation. On the flip side, South Dakota and Wisconsin are the only Midwestern states that do not cap the interest rate on payday loans. Both, however, limit the maximum loan amount.

In light of recent growth in online payday lending, Minnesota passed legislation in 2009 that made the state’s lending laws applicable to Internet payday lenders making loans to Minnesota residents.
This year, legislation in Iowa that would have capped interest rates at 36 percent died in committee. In the absence of statewide restrictions, some Iowa cities, including Des Moines and West Des Moines, have placed moratoria on new payday-lender businesses.

This year in Wisconsin, payday regulation was approved by the Legislature. While not imposing a cap on the interest rates charged, the new law does limit loan amounts to $1,500 or 35 percent of monthly income. It also restricts loans to only one rollover, requires a database to prevent borrowing from multiple lenders, and restricts payday lending stores from being located within 1,500 feet of each other or 150 feet from certain residential zones.

Wisconsin’s new statute also prohibits auto-title loans. Five other Midwestern states have banned such loans: Indiana, Michigan, Nebraska, North Dakota and Ohio. Iowa caps these loans at a 35 percent annual interest rate, while Minnesota caps them at 116 percent. On the other hand, Illinois, Kansas and South Dakota allow auto-title loans with no restrictions on the annual percentage rate charged to lenders.

Recently, Indiana tried to enforce its prohibition of auto-title loans against lenders in Illinois to keep them from issuing title loans to Indiana residents. This attempt was held to be unconstitutional by a federal court, a decision affirmed on appeal.


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