

Ohio Tightens Small Dollar Lending Law

McGlinchey Consumer Financial Services Alert

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On July 24, 2018, Ohio Governor Kasich signed HB 123 into law, amending and streamlining the Ohio consumer lending laws and making significant changes to the Ohio Short-Term Loan Law. The changes contained in HB 123 include:

- Requiring a nonbank lender to obtain a Short-Term Loan Law license to originate any consumer loan with a maximum amount of \$1,000 or repayable in a year or less;
- Revising the Credit Services Organizations Act to prohibit registered Credit Services Organizations from assisting in the origination of short-term loans, loans of less than \$5,000, and loans with an annual percentage rate greater than 28%;
- Eliminating Ohio's loan database;
- Requiring that all short-term loans be precomputed;
- Requiring that licensed short-term lenders verify and document a borrower's income;
- Applying an ability-to-repay standard for loans of certain terms;
- Capping interest, fees, and charges;
- Requiring that licensed short-term lenders offer a right to cancel;
- Prohibiting contact with borrowers and certain repayment methods; and
- Permitting online lending.

The law becomes effective October 29, 2018 and lenders must comply with these provisions for loans made beginning on April 27, 2019.

Short-Term Loan Law License Requirement

Until the passage of HB 123, consumer lenders in Ohio could originate loans pursuant to one of three licensing laws: the General Loan Law, the Small Loan Act, or the Consumer Installment Loan Act. These laws overlapped and provided lenders with a modicum of flexibility in providing short-term or small-dollar loans to their customers.

In addition to making wholesale revisions to the Ohio Short-Term Loan Law (discussed further below), expanding the statute to apply to loans of \$1,000 or less or with a term of a year or less, HB 123 amends Ohio's other consumer lending laws to exclude loans of \$1,000 or less with a term of a year or less. The Short-Term Loan Law now exclusively governs short-term loans, and lenders seeking to make loans of \$1,000 or less, or with a term of a year or less, must comply with its provisions.

Credit Services Organizations

HB 123 also modifies the Ohio Credit Services Organization Act. The Ohio Credit Services Organization Act requires entities that, among other things, aid buyers in obtaining an extension of credit, to register and file a bond. Some Ohio lenders have historically partnered with a registered credit services organization (CSO) in a manner that, when the CSO's fee and loan interest charges are combined, legally resulted in an annual percentage rate that typically exceeded the contract interest rate permitted under the Ohio consumer lending laws (usually 25%) by a substantial margin.

Once HB 123 takes effect, registered CSOs will be prohibited from selling, providing, or performing any of its services, including aiding a buyer in obtaining an extension of credit, if the extension of credit meets any of the following conditions: (1) the amount of credit is less than \$5,000, (2) the repayment term is one year or less, or (3) the annual percentage rate is greater than 28%. HB 123 provides that violating this prohibition is a strict liability offense, resulting in a criminal penalty of a misdemeanor and a fine. Thus, with respect to short-term loans, loans under \$5,000, or loans with an annual percentage rate greater than 28%, the CSO lending model will no longer be available.

Elimination of Ohio's Short-Term Loan Database

HB 123 dismantles Ohio's loan database, which licensees previously used to determine whether a borrower was eligible to receive a loan. Under the revised Short-Term Loan Act, licensed short-term lenders and their affiliates may not make concurrent short-term loans to a borrower. Although consumers will be eligible to obtain additional short-term loans from unrelated lenders, lenders are required to make a "concerted effort" to ensure the consumer has no more than \$2,500 in short-term loans outstanding at any one time. A licensee must require each borrower to sign a written declaration that the borrower is eligible to receive the loan. HB 123 does not provide a safe-harbor for how a lender makes a "concerted effort." Until the Ohio Department of Commerce – Division of Financial Institutions provides guidance, lenders will need to develop appropriate processes that may include the use of an alternative credit reporting bureau to confirm that the consumer does not have more than \$2,500 outstanding in short-term loans.

Short-Term Loans Must be Precomputed

Short-term loans must be precomputed and payable in substantially equal installments consisting of principal, fees, and interest. A precomputed loan is a loan in which the debt is a sum comprising the principal amount and the amount of fees and interest, computed in advance on the assumption that all scheduled payments will be made when due.

In other words, the amount due is fixed and final (and will not vary depending on the borrower's payment history), and the payment terms should be clear to borrowers.

Verification of Income and Recommended Repayment Term

Like the CFPB's Payday Loan Rule, short-term lenders must verify and document a borrower's income. HB 123 requires the lender to, at minimum, obtain from the borrower one or more recent pay stubs or other written evidence of recurring income, such as a bank statement. The written evidence must include the borrower's initiation of the short-term loan transaction. Further, if the borrower intends to provide a bank statement, the licensee must permit the borrower to delete from the statement the information regarding to whom the debits listed on the statement are repayable.

If the duration of a loan is greater than 90 days, the licensed Short-Term lender must recommend a repayment term for the loan—based on the borrower's verified income—and provide the recommendation to the borrower in writing. Consequently, the lender must develop a methodology for determining its recommendation. Presumably, the recommendation must be sensitive to the borrower's ability to make monthly payments, but no additional guidance is provided. In any event, the recommendation is not binding on the borrower.

Ability-To-Repay Requirement

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For loans that must be repaid between 31 and 90 days, Short-Term Loan Law licensees must comply with an ability-to-repay (ATR) requirement. The total monthly payment must not exceed an amount that is 6% of the borrower's verified gross monthly income, or 7% of the borrower's verified net monthly income, whichever is greater. Please refer to our earlier discussion of how a lender must verify income. When applicable, the ATR requirement will further limit the loan amount, except for borrowers with relatively high incomes.

Interest, Fees, and Charges

HB 123 limits the interest, fees, and charges that may be charged by a Short-Term Loan Law licensee making a covered loan. The loans must be precomputed, and the interest rate may not exceed 28% per year. In addition, the lender can assess the following charges:

- A monthly maintenance fee may be charged that does not exceed the lesser of 10% of the loan amount or \$30
 - No interest may be accrued on the maintenance fee
 - No monthly maintenance fee is permitted if the borrower is an active duty member of the military or a dependent of a military member
- A loan origination charge of 2% if the original loan amount is \$500 or more
 - Interest may not accrue on the loan origination charge
- A check cashing fee of \$10

Note that prior to HB 123, a licensee was only permitted to charge a check cashing fee in addition to interest. The total amount of fees and charges may not exceed 60% of the originally contracted loan amount—not including check collection charges, check cashing fees, and interest charges on a refinanced loan. Loans that approach the term limit may reach the 60% limit due to the maintenance fee. Lenders will need to determine how they will ensure compliance with this limitation.

Right to Cancel

Borrowers now have the right to rescind a short-term loan within three business days. Lenders must provide consumers with a written notice that explains this right along with details regarding the process the borrower must follow to rescind the loan. Short-Term Loan licensees will need to amend their Ohio notes to include the statutory notice.

Additionally, if a short-term loan is prepaid in full or refinanced prior to the loan's maturity date, lenders must refund to the borrower a prorated portion of the interest, monthly maintenance fees, and all other charges based on a ratio of the number of days the loan was outstanding and the number of days for which the loan was originally contracted. The monthly maintenance fee is not considered to be fully earned at the beginning of a month, and thus must be prorated as well.

Lenders seeking to make loans pursuant to the Short-Term Loan Law must ensure that they have policies and procedures in place to properly respond to a consumer's decision to rescind the short-term loan or to prepay the loan in full prior to the loan's maturity date.

Prohibitions

The Short-Term Loan Law prohibits licensed lenders from contacting a borrower for any reason other than for the borrower's benefit regarding upcoming payments, options for obtaining loans, payment options, payment due dates, the effect of default, or, after default, receiving payments or other actions permitted by the licensee; to advise the borrower of missed payments or dishonored checks; or to assist the transmittal of payments via a third-party mechanism. This appears designed to prohibit marketing new or refinanced loans to consumers.

Mirroring the CFPB's Payday Loan Rule, a licensed short-term lender cannot collect from a borrower's account using ACH debits after two consecutive attempts have failed, unless the lender obtains a new written authorization from the borrower to electronically transfer or withdraw funds from the borrower's account. Additionally, licensed short-term lenders are now prohibited from securing a short-term loan with a car title or registration, in addition to the current law's prohibition on a short-term lender taking real property, physical assets, or other collateral as security for the obligation. This prohibits the lender from extending a title-secured loan in addition to an auto equity loan.

Online Lending

Although originating a loan by mail or phone is still prohibited, short-term lenders are now permitted to make short-term loans online. All of the requirements of the Short-Term Loan Act will apply, regardless of the origination channel. Lenders who previously had been unable to make covered loans in Ohio, as they did not have an in-state brick and mortar location, can now consider obtaining a Short-Term Lending license and extending such loans.

Penalties

Any covered loans made by an unlicensed lender are void and the lender has no right to retain any principal, interest, fees or other charges. Moreover, other violations of the Short-Term Loan Law are punishable by a monetary fine of up to \$1,000 for each violation, and short-term lenders may be investigated to identify conduct that would justify the suspension, revocation, or refusal of an original or renewal license.

Conclusion

As a result of HB 123, lenders in Ohio seeking to make loans of \$1,000 or less or with a duration of less than a year must obtain the Short-Term Loan license. Lenders holding one of the other Ohio lender licenses who wish to continue making short-term, small-dollar loans in Ohio subject to the terms of the Short-Term Loan Law should apply to obtain a Short-Term Loan license to avoid business disruption. Otherwise, non-exempt lenders in Ohio may need to adopt a minimum loan amount of \$1,001 and a minimum loan term of one year and ensure that their practices are in compliance with the terms of their existing license.

HB 123 becomes effective October 29, 2018, and the mandatory compliance date is April 27, 2019 – 180 days after the effective date. Please contact us if you would like assistance in applying for an Ohio Short Term Loan license or to discuss potential changes to your business model.

For more information, please reach out to the authors of this alert or another member of the firm's Consumer Financial Services Group.