



ATTORNEY GENERAL OF TEXAS
GREG ABBOTT

January 12, 2006

Ms. Leslie Pettijohn, Commissioner
Office of the Consumer Credit Commissioner
2601 N. Lamar Blvd.
Austin, Texas 78705-4207

Dear Commissioner Pettijohn:

Pursuant to a request in August 2005, this office began looking into the recent change in lending practices within the payday loan industry to begin use of the credit services organization, or CSO, model. Shortly thereafter, we received a letter from Senator Eliot Shapleigh asking the Office of the Attorney General (OAG) to review the same practices, and we were also copied on a letter from consumer advocates asking you to request enforcement action by the OAG against payday lenders based on the contention that such practices violate state consumer lending laws. Based on these three requests, this office embarked upon a review of the CSO model. As a preliminary matter it must be noted that this letter is not a formal Attorney General opinion which is subject to exhaustive review and public comment, but is merely the analysis of a team of attorneys at our office based on information provided to this office, visits with members of industry, consumer advocates and state agency personnel, and a review of relevant law. Our analysis is as follows:

In July 2005, as a result of a change in federal guidelines controlling the number of payday loans national banks may make, the payday loan industry developed a new model for making payday loans based on existing Texas laws authorizing credit services organizations. TEX. FIN. CODE ANN. §§393.001-.505. Under these statutes, those who formerly operated under the national bank model now structure themselves as a CSO in order to obtain loans for consumers through third party lenders. The interest amount charged by the third party lender is 10%, conforming with Article 16, Section 11 of the Texas Constitution. A fee is charged by the CSO to arrange for the loan. (Notably, the total fees charged by the CSO plus the 10% interest often may make loans under this model more expensive than traditional payday loans.)

The first question raised by this new model is whether there is any limit on the amount of fees in these transactions under Chapter 393 of the Finance Code. We believe there is not. Although the legislature designed the statutes to provide for CSOs to assist in obtaining mortgage financing for consumers, the plain language of the law does not limit its use to only mortgage finance transactions. Also, there is no limit in the CSO statutes on the amount of fees that may be charged by a CSO. Additionally, an alternative use of the CSO model was examined and upheld by the U.S. Fifth Circuit Court of Appeals in Lovick v. Ritemoney Ltd., 378 F.3d 433 (5th Cir. 2004). Based on these facts, on its face the CSO model does not appear to be prohibited under Texas law.

Ms. Leslie Pettijohn

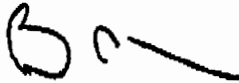
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The next question raised by the model is whether the lender and the CSO are truly independent. By definition, a CSO is one who arranges for the extension of credit to a consumer "by others." TEX. FIN. CODE ANN. §393.001(3). The only reason we believe a lender would agree to make these loans is because the CSO is guaranteeing, through a letter of credit or otherwise, that the loan will be repaid. While this aspect of the model raises many questions, theoretically, if the CSO and the lender are truly independent actors, there would be nothing patently illegal about the model. Determining the true relationship between a CSO and a lender would be a fact-intensive endeavor.

Any discussion of whether the use of this model is the best public policy choice for the State of Texas is one that must be addressed by the legislature and has not been explored by this office. As the attorney representing your office, we will act on referrals from you for enforcement actions under the statutes. We remain committed to work with your office, the legislature and the payday lending industry to find a balanced approach that is legally sound and good for Texas. If you have any questions, please feel free to contact our office again.

Sincerely,



Barry R. McBee
First Assistant Attorney General