

**STATE OF MICHIGAN  
DEPARTMENT OF LABOR AND ECONOMIC GROWTH  
OFFICE OF FINANCIAL AND INSURANCE SERVICES**

**Bulletin 2006-06-CF**

**In the matter of  
Credit Services Organizations, Regulatory  
Loan Act and Consumer Financial Services Act  
Licensees and Short-Term (Payday) Loans**

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**Issued and entered  
this 21st day of June 2006  
By Linda A. Watters  
Commissioner**

OFIS has been made aware of a proposed business model that would involve the issuance of short-term or "payday" loans through the agency of a credit services organization ("CSO"), organized and operating pursuant to provisions of the Credit Services Protection Act ("CSPA"), 1994 PA 160, as amended, MCL 445.1821 *et seq.* The underwriter of these loans would be a lender regulated under the Regulatory Loan Act ("RLA"), 1939 PA 21, as amended, MCL 493.1 *et seq.*, and licensed under either the RLA or the Consumer Financial Services Act, 1988 PA 161, as amended, MCL 487.2051 *et seq.*

The Commissioner has thoroughly and carefully considered and reviewed the dynamics of the proposed CSO payday loan business model and finds it to be prohibited by both the RLA and the CSPA. A reasonable review of this business model can only conclude that it is a deceptive subterfuge designed to extract impermissible fees from a borrower. The purpose of this business model appears to be to avoid the interest rate limits of the RLA as well as the fee limitations placed on deferred presentment service transactions, commonly known as payday loans, by the recently enacted Deferred Presentment Service Transactions Act ("DPSTA"), 2005 PA 244, MCL 487.2121 *et seq.*

Under a proposed CSO payday loan business model, a consumer seeking a short-term payday loan would enter a retail outlet operated by a CSO and make application for a short term loan for an amount between \$200 - \$1800. The consumer would provide the CSO with evidence of employment, residency, citizenship, and an active bank account. The consumer would either be required to provide the CSO with a loan repayment check made out to the regulated lender in the amount of all monies due to the regulated lender and postdate the check to the maturity date of the loan, or the consumer must authorize the regulated lender or its agent to initiate an electronic debit for all monies owed to the regulated lender upon maturity of the loan. The consumer must also agree

to allow the CSO to provide so-called "credit enhancement" from an entity acceptable to the regulated lender. The CSO would charge the consumer a fee for brokering the loan and for providing so-called "credit enhancement" by issuing a letter of credit to a lender regulated under the RLA in the amount of the total of payments on the loan agreement. The regulated lender would then be entitled to draw on the letter of credit in the event the consumer defaults under the terms of the loan. The consumer authorizes the regulated lender to pay the CSO's fee on the consumer's behalf from a portion of the loan proceeds the consumer receives from the regulated lender.

The regulated lender shares its underwriting guidelines with its agent, the CSO. If the CSO believes a consumer will qualify for a loan utilizing the regulated lender's underwriting guidelines, the CSO will then assist the consumer with completion of the loan application and any other documents required by the regulated lender for issuance of the loan. The regulated lender would fund the loan in the form of a voucher. The CSO would cash the voucher issued by the regulated lender to the consumer as an additional service to the consumer. The loan would then be scheduled to be repaid by the consumer in one lump sum payment including principal and interest. The regulated lender delays presentment of the consumer's check, or initiation of the Electronic Funds Transfer ("EFT"), for one business day after maturity of the loan. If the consumer defaults on the loan the regulated lender may draw on the letter of credit, and the CSO will attempt to obtain reimbursement from the consumer for any amount paid by the CSO under the letter of credit, plus any other charge, i.e. NSF fee, owed from the consumer.

#### WHY THE PROPOSED BUSINESS MODEL IS PROHIBITED: THE DPSTA SPECIFICALLY GOVERNS THESE TRANSACTIONS.

Michigan recently enacted the DPSTA, a comprehensive law which addresses the same type of transactions that are the subject of this business model. Under the DPSTA, MCL 487.2122(g), a deferred presentment service transaction is defined as:

a transaction between a licensee and a customer under which the licensee agrees to do all of the following:

- (i) Pay to the customer an agreed-upon amount in exchange for a fee.
- (ii) Hold a customer's check for a period of time before negotiation, redemption, or presentment of the checks.

Under the CSO payday loan business model, the operative facts are virtually the same as a deferred presentment transaction. In the CSO payday loan business model, the regulated lender delays presentment of the consumer's check, or initiation of an EFT, for one business day after maturity of the loan. The loans offered by the regulated lender typically mature in 14 days. If the consumer defaults on the loan the regulated lender may draw on the letter of credit, and the CSO will attempt to obtain reimbursement from the consumer for any amount paid by the CSO under the letter of credit, plus any other charge, i.e. NSF fee, owed from the consumer. Under this plan, the regulated lender, in concert with the CSO, is performing the same function that is

defined as a deferred presentment service transaction. In exchange for a fee, which, in this case is interest and fees charged, the regulated lender will pay to the consumer an agreed upon amount. Then the consumer's check will be held for a period of time before negotiation. Thus, aside from the protections offered under the DPSTA, the consumer will not notice any difference in the service he receives. A regulated lender that uses the CSO payday loan business model is engaging in an activity that the Legislature intended be governed by the DPSTA. The DPSTA is the more recent and specific statute addressing these kinds of transactions, and is the law that governs.

#### EXCEPTIONS IN THE DPSTA DO NOT APPLY TO THE PROPOSED CSO BUSINESS MODEL.

The CSO payday loan business model does not fall within any exception to the DPSTA. Section 2(2) of the DPSTA, MCL 487.2122(2), provides:

(2) Deferred presentment service transaction does not include a delay in presentment of a loan repayment check, at the request of the borrower, by a person licensed or registered under the consumer financial services act, 1988 PA 161, MCL 487.2051 to 487.2072, the regulatory loan act, 1939 PA 21, MCL 493.1 to 493.24, the secondary mortgage loan act, 1981 PA 125, MCL 493.51 to 493.81, the motor vehicle sales finance act, 1950 (Ex Sess) PA 27, MCL 492.101 to 492.141, 1984 PA 379, MCL 493.101 to 493.114, the sale of checks act, 1960 PA 136, MCL 487.901 to 487.916, or the mortgage brokers, lenders, and servicers licensing act, 1987 PA 173, MCL 445.1651 to 445.1684.

The above section provides an exception to the DPSTA only when a **borrower** requests a delay in presentment of a loan repayment check. However, this exception does not apply when the borrower is required, as he would be under the loan agreement in a CSO business model, to give a contractual right to cash the borrower's check or ACH authorization on a deferred basis as a condition of the loan

#### THE PROPOSED BUSINESS MODEL REQUIRES THE CSO AND THE REGULATED LENDER TO ACT IN CONCERT IN A MATTER THAT VIOLATES THE RLA AND THE CSPA.

Under the proposed business model, a lender subject to the RLA intends to make loans to consumers only through its agent, a CSO. The regulated lender has no real intent to make loans directly to consumers and consumers will have no opportunity to solicit the lender to obtain a loan other than going through the facade of a CSO. The regulated lender may not have any offices or places of business in the State of Michigan. The only way for a consumer to obtain a loan in Michigan from the regulated lender in this model is to go through its agent, the CSO. Under this scheme, the consumer must pay the CSO a fee in order to obtain a loan from the regulated lender. This arrangement

violates Sections 13(4) and 18 of the RLA, MCL 493.13(4) and 493.18. Section 13(4) of the RLA, MCL 493.13(4), provides in pertinent part:

In addition to the interest and charges provided for in this act, a loan processing fee not to exceed 5% of the principal, up to \$250.00, may be charged for each closed-end loan made, and may be included in the principal of the loan. The \$250.00 limit on the loan processing fee shall be adjusted every 2 years to reflect the percentage change in the United States consumer price index for the 2 immediately preceding calendar years, rounded to the nearest hundred dollars.

Section 18 of the RLA, MCL 493.18, provides in pertinent part:

(1) A person, except as authorized by this act, shall not directly or indirectly charge, contract for, or receive an interest, discount, or consideration greater than the lender would be permitted by law to charge if the lender were not licensed under this act upon the loan, use, or forbearance of money, goods, or things in action.

(2) The prohibition specified in subsection (1) applies to a person who or which, by any device, subterfuge, or pretense charges, contracts for, or receives greater interest, consideration, or charges than authorized by this act for the loan, use, or forbearance of money, goods, or things in action or for the loan, use, or sale of credit.

Under the RLA, a regulated lender is permitted to charge a rate of interest of no more than 25% per annum and a closed-end loan loan-processing fee of the lesser of \$300.00 or 5% of the principal loan sum. A regulated lender is prohibited from charging, contracting for, or receiving, either directly or indirectly, any other amount of money, except for certain specified governmental filing fees, MCL 493.13(1) and (4). The RLA clearly prohibits a person involved in a transaction regulated by the Act from utilizing any device, subterfuge, or pretense to charge, contract for, or receive any greater interest or fee than that authorized by the Act. Accordingly, regardless of the CSO's participation, the transaction is still limited to a loan processing fee of the lesser of 5% or \$300.00 and a rate of interest not to exceed 25% per annum.

Moreover, Section 3 of the CSPA, MCL 445.1823(c), provides in pertinent part:

A credit services organization, a salesperson, agent, or representative of a credit services organization, or an independent contractor who sells or attempts to sell the services of a credit services organization shall not do any of the following:

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(c) Charge a buyer or receive from a buyer money or other valuable consideration solely for referral to a retail seller who will or may extend credit to the buyer if the credit that is or

may be extended to the buyer is substantially the same as that available to the general public.

Even if a regulated lender were to also offer loans directly to Michigan consumers, the lender's compelled use of the CSO would require the CSO to engage in conduct that violates Section 3(c) of the CSPA, MCL 445.1823(c), which prohibits a CSO from accepting a fee "solely for referral to a retail seller who will or may extend credit to the buyer if the credit that is or may be extended to the buyer is substantially the same as that available to the general public." Under the proposed business model a consumer should not be required to utilize a CSO when the service offered by the CSO can be obtained directly by the consumer.

The Commissioner advises any applicant or lender subject to the RLA who proposes to engage in the business of offering short-term loans of the type described in this bulletin to review its business model and practices to ensure that it is in compliance with the interpretation set forth in this bulletin. If OFIS becomes aware of any entities that are operating under this business model in Michigan, OFIS will initiate administrative action to enforce the relevant provisions of the RLA and will ask the Attorney General to initiate appropriate action under Section 4 of the CSPA, MCL 445.1824.

Any questions regarding this bulletin should be directed to:

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