



# OLR RESEARCH REPORT

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## **PAYDAY LENDING**

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You asked for an analysis of the legal restrictions on payday lenders who issue loans to Connecticut borrowers.

### **SUMMARY**

Payday loans are small-dollar, short-term loans that borrowers promise to repay out of their next pay check. The effective annual interest rates on payday loans are very high.

Connecticut law does not specifically address payday loans. However, the requirements of Connecticut's small loan law and check casher law have the practical effect of restricting payday lending by limiting who can make small loans and the amount of interest they may charge. Connecticut's usury limits also serve as a limit on payday loans in the state.

### **PAYDAY LOANS IN GENERAL**

In the traditional retail model, borrowers visit a payday lending store and secure a small cash loan, with payment due in full when the borrower gets his or her next paycheck. The borrower writes a postdated check to the lender for the full amount of the loan plus fees. If the borrower does not repay the loan on the due date, the lender may redeem the check.

Prospective borrowers may also complete payday loan applications online. In some instances they may also fax the application, especially where documentation is required. The loan is then transferred by direct deposit to the borrower's account, and the loan repayment and finance charge are electronically withdrawn on the borrower's next payday.

Legislation regarding payday loans varies across states. Payday lending is legal and regulated in some states. In others, it is illegal. In some, like Connecticut, though not explicitly illegal, laws governing lending make it impossible to make payday loans, as the term is generally understood. When not explicitly banned, laws that restrict payday lending are usually in the form of usury limits: i.e. interest rate caps calculated strictly by annual percentage rate (APR). Since October 1, 2007, federal law has capped lending to military personnel at a maximum of 36% APR as defined by the secretary of defense (John Warner National Defense Authorization Act for Fiscal Year 2007).

## **PAYDAY LOANS IN CONNECTICUT**

Connecticut's small loan law and check casher law restrict payday lending (CGS §§ [36a-563](#), [-565](#), and [-581](#), Conn. Agencies Reg. § 36a-585-1). Connecticut's usury limits also serve as a bar to payday loans (CGS §§ [37-4](#) and [-9](#)).

### ***Small Loan Law***

In Connecticut, only a person or entity licensed with the Banking Department as a small loan lender, banks, credit unions, and pawnbrokers can make small consumer loans up to \$15,000 at a rate greater than 12% per year. The interest rate that a licensed person may charge depends on whether the loan is an open-end loan or close-end loan. On open-end loans, a licensed person can charge 19.8%. For closed-end loans the actual interest rates vary, depending on the length of the loan, but are much lower than typical rates on payday loans. The law allows the following charges on closed-end loans:

1. \$17 per \$100 for the first \$600 and \$11 per \$100 on any remainder up to \$1,800 or on any loan unsecured or secured only by credit life insurance; and
2. \$11 per \$100 on secured loans over \$1,800 (CGS §§ [36a-563](#) and [-565](#)).

Connecticut's small loan law also prohibits the assignment of wages as security for a loan (CGS § [36a-568](#)). This may restrict payday loans if they are considered loans made with the expectation of repayment from the next paycheck.

### ***Check Cashier Law***

Connecticut statutes also license check cashing businesses. Regulations allow them to charge no more than a 2% fee for cashing a check (CGS § [36a-581](#), Conn. Agencies Reg. § 36a-585-1).

### ***Usury Law***

Another Connecticut law establishes a 12% general usury limit. This limit applies to anyone making consumer loans in the state that is not specifically exempted in the statutes (CGS §§ [37-4](#) and [-9](#)).

MK:ro