SFA BILL ANALYSIS

Senate Fiscal Agency • Lansing, Michigan 48909 • (517) 373-5383

Senate Bill 383 (Substitute S-1 as reported)
Sponsor: Senator Dick Posthumus
Committee: Commerce and Technology

Date Completed: 9-30-87

RATIONALE

Without legislative action, the maximum allowable interest rate on a car loan issued by a credit union or other depository institution will revert from 16.5% to 15% on December 31, 1987. The sunset on this interest rate ceiling has been extended a number of times since 1980, and many believe that the sunset should be eliminated. Further, some believe that different ceilings should be set, as in the Motor Vehicle Sales Finance Act, in order to promote fair competition between depository institution and dealer-affiliated finance companies.

CONTENT

Senate Bill 383 (S-1) would amend the credit union Act to eliminate a December 31, 1987, sunset on a provision that allows credit unions (and other depository institutions) to charge a rate of 16.5% or less annually on the unpaid balance of an automobile loan. Under the Act, that rate may be charged only on a loan made on or before December 31, 1987. Instead, the bill would permit a credit union to charge different interest rates for motor vehicle purchases, depending on the age of the vehicle to be purchased. A vehicle from a model year that was the same as or one year before the year of the sale could be financed at 16.5% or less annually; a vehicle from a model year that was two years before the year of the sale could be financed at 19% or less annually; and a vehicle from a model year that was three years or more before the year of the sale could be financed at 22% or less annually.

MCL 490.14

BACKGROUND

In 1980, the Legislature raised the interest rate ceilings on car loans to 16.5%, but placed an expiration date of June 1, 1981, on those ceilings. The sunset date was postponed three times during the 1981-82 session, but finally was set at December 1, 1983. (When the December 1, 1983, sunset arrived, the statutory maximum annual interest rate reverted to 14.55% for savings and loan associations, 12.83% for banks, and 15% for credit unions.) In 1983, a package of House bills (House Bills 4449-4452) was introduced to address car loan interest rates. House Bill 4449 (Public Act 246 of 1983) amended the Motor Vehicle Sales Finance Act, regulating loans by finance companies and motor vehicle dealers, to remove the sunset; House Bill 4450 (Public Act 359 of 1984) amended the Savings and Loan Act to extend the sunset to December 31, 1985; House Bill 4451 (Public Act 60 of 1984) amended the credit union Act to extend the sunset to December 31, 1984; and House Bill 4452 would have amended the Banking Code to remove the sunset, but was vetoed. The credit union Act again was amended in 1986 (Public Act 20 of 1986) to extend the sunset date to December 31, 1987.

Under the "most favored lender" doctrine, by which State- and Federally- chartered depository institutions may charge the most favorable interest rate allowed to a competitor, many savings and loan associations and banks have applied the 16.5% interest rate ceiling allowed for credit unions. If that ceiling expires, the highest rate any of the institutions will be allowed to charge under the "most favored lender" doctrine is the 15% general (or "default") interest ceiling in the credit union Act.

FISCAL IMPACT

The bill would have no fiscal impact on State or local government.

ARGUMENTS

Supporting Argument

Under the "most favored lender" doctrine, depository institutions can charge up to 16.5% annually on the unpaid balance of auto loans, as permitted in the credit union Act. The Motor Vehicle Sales Finance Act, which regulates loans made by finance companies and motor vehicle dealers, however, allows a varying ceiling on interest rates, depending on the age of the purchased vehicle. There is considerable legal disagreement as to whether depository institutions can use the rate system specified in the Motor Vehicle Sales Finance Act under the "most favored lender" doctrine. Consequently, the same staggered ceilings should be incorporated into the credit union Act in order to ensure fair competition between depository institutions and finance companies and auto dealers in the auto loan market.

Supporting Argument

By amending various statutes over the last several years, the Legislature repeatedly has extended the 16.5% interest rate ceiling on car loans. It is now clear that 16.5% is a reasonable ceiling, so the sunset on that ceiling should be eliminated.

Response: While the 16.5% ceiling may have been appropriate and reasonable in the past, when car loan rates averaged 13% to 14.5%, interest rates have dropped dramatically in the last two years, and it may be that 16.5% is in fact unreasonably high. Since future interest rates cannot be predicted with any certainty, the law should ensure that the Legislature reexamines this issue periodically.

Opposing Argument

Depository institutions should not be permitted to use the same interest rate ceilings as auto dealers unless some of the consumer protection provisions within the Motor Vehicle

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Sales Finance Act (e.g., the consumer's right to withhold payments if the vehicle is defective) are incorporated into laws regulating depository institutions.

Response: The consumer protection provisions built into the Motor Vehicle Sales Finance Act are not germane to loan contracts from depository institutions. Since a credit union or other financial institution is not a party to the actual sale of the vehicle, as is a dealer-affiliated finance company, a depository institution should not be penalized if a vehicle is sold with some defect.

Opposing Argument

The age of a car should not be a factor in setting the terms of an auto loan contract. The rationale for the higher ceilings in the Motor Vehicle Sales Finance Act is based on the fact that dealers historically have had higher financing costs than have lending institutions. Depository institutions have a ready supply of funds to be loaned, but dealers (often small, mainly used car operations) have had to sell their paper to those with easier access to funds. Consequently, dealers have had to charge higher rates in order to profit from financing consumers' purchases.

Response: Auto dealers may have had much greater financing costs at one time, but the prominence of large dealer-affiliated finance companies, such as GMAC, in today's market has changed that barrier to access of funds. The finance companies operating in today's auto loan market compete with depository institutions for that business and all the competitors should have to operate by the same standards.

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