House
Legislative
Analysis
Section

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REGULATORY LOAN ACT: GEN'L. AMENDMENTS

Senate Bill 257 (Substitute H-3)
First Analysis (6-5-90)

JUN 12 1990

Sponsor: Sen. Doug Cruce
Senate Committee: Commerce & Technology
House Committee: Corporations & Finance

THE APPARENT PROBLEM:

The Regulatory Loan Act regulates non-depository financial institutions in the business of offering small loans (up to $3,000) to consumers. The act was last amended in 1978 to update it to conform with trends in regulating small loan companies throughout the country, for things such as interest rate and loan ceilings. In the last 11 years, many restrictions within the financial services industry have been eased to allow these types of lenders to offer higher loans at higher interest rates to consumers. In fact, many states have no caps at all, which can be both good and bad for both lenders and consumers of these types of loans: as these loans are used more often by low-to-middle income consumers, in other states these borrowers have access to more credit but are subject to more risk; lenders, too, can make more money but also are subject to more risk. Some people feel Michigan's regulatory loan law, in setting lower loan caps and interest rate limits, hurts both lenders and consumers by discouraging these types of lenders from doing business here and thereby reducing the amount of available money — albeit, in the form of high-interest credit — to lower income consumers. According to the Financial Institutions Bureau (FIB), the number of small loan companies operating in Michigan has fallen over the last 15-20 years from nearly 700 to 38. While the state's dramatic decrease in these types of lenders has probably also been due to an increase in credit services offered by credit unions, some feel the state's regulatory loan law shares much of the blame and needs to be amended to correct this trend. Also, the FIB currently charges license applicants a $150 application fee, with the total amount being used by the bureau for its duties in licensing and examining persons under the act. Because the money from this fee apparently does not cover its costs in regulating licensees, the bureau would like to raise certain fees and establish a specific examination fee based on an hourly rate. Other amendments have also been requested to update the act as it applies to various record-keeping procedures of licensees.

THE CONTENT OF THE BILL:

The bill would amend the Regulatory Loan Act to increase the regulatory loan ceiling, provide for biannual rather than annual examinations of licensed lenders, increase examination, loan processing, and check-handling fees, and change the act's provisions concerning disclosure statements, license eligibility criteria, and interest rates. The bill would take effect October 1, 1990.

Examinations. Currently, the commissioner of the Financial Institutions Bureau (which regulates licensees) is required to examine each licensee annually and may investigate the loans and business, or examine the books, accounts, records, and files, of every licensee and anyone engaged in the business of making loans. The bill would require the commissioner, instead, to examine licensees at least once every two years. Examination provisions could not be construed to prohibit the keeping of records by electronic data processing methods. Books and accounts could be kept at a location other than the licensee's principal place of business, provided they were made available to the commissioner and the licensee paid the "actual and reasonable" travel expenses of an examiner if he or she had to travel out of state. Also, a licensee is now required to file with the commissioner by February 15, and every third year thereafter, a report detailing his or her business operations during the previous three years. The bill would change the filing date to March 15. This report would be exempt from disclosure under the Freedom of Information Act unless the commissioner found that its disclosure would be in the public's interest.

Licensing, Examination Fees. Under the bill, the annual license fee would no longer cover examinations; instead, the cost of an exam would be based on a rate of not less than $20 nor more than $40 per hour for each examiner involved. The act currently requires a license applicant to pay an investigation fee of $150 at the time of application; the bill would raise this to $300. In addition, the bill would raise the annual license fee from $250 to $300. An examination fee would be invoiced when an exam was finished and would be due and payable when the licensee received the invoice. A licensee would not have to pay for more than one examination in a calendar year. In addition, the bill specifies that the commissioner could maintain a cause of action in the court of claims to recover any fees a licensee failed to pay. Fees collected would be paid into the state treasury and credited to the bureau. (The act currently credits fees collected to the general fund.)

Interest Rate, Loan Ceilings. The act currently allows a licensee to charge a monthly interest fee of up to one-twelfth of either 1) 18 percent per year of the unpaid principal balance up to the regulatory loan ceiling (currently, $3,000), or 2) a combination of 31 percent per year on the unpaid principal balance up to $500 and 13 percent per year on the unpaid principal balance over $500 up to the loan ceiling. These provisions would be deleted and the bill, instead, would provide for an interest rate ceiling of 22 percent per year on the unpaid balance. (However, the rate on a motor vehicle loan could not exceed the rate provided for this type of loan under the Motor Vehicle Sales Finance Act.) Also, the loan ceiling would be raised from $3,000 to $8,000.

The bill would delete provisions that require loan charges to be paid only as a percentage per month of the unpaid principal balance, as well as provisions which state that a licensee who advertises aggregate, combination, or graduated rates must first state the higher rate applicable to a portion of the loan and give the highest rate equal prominence with the lower rate applicable to the remainder of the loan.

Loan Processing Fees. The bill specifies that, in addition to interest, a licensee could charge a loan processing fee that

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did not exceed two percent of the principal, up to $40, for each loan made; this fee could be included in the loan's principal. However, a licensee could not receive such a fee for a loan contract that was renegotiated, renewed, or modified, nor for a loan contract that was issued to obligate a person to repay a sum of money that had previously been lent to a person through a prior loan contract by the licensee. A licensee could charge a $5 handling fee for the return of an unpaid and dishonored check, draft, negotiable order, or similar instrument given the licensee in full or partial repayment of a loan.

Obligation in Improper Loan Contract. The act currently specifies that, except in the case of a "bona fide clerical error," a loan contract not invalid for another reason is void and the lender cannot collect or receive any principal, interest, or charges if an act is committed in the making or collecting of the loan that constitutes a misdemeanor. The bill would reword this to specify that a person who committed a misdemeanor in the making or collecting of an otherwise legitimate loan, except in the case of "accidental, bona fide, or judicially determined justifiable error," would be barred from recovery of interest or principal. A court, however, could provide for recovery of the principal if it found that the violation occurred as a result of "good faith reliance on documented advice" of government regulators or the attorney general.

Other Provisions. The bill also would do the following:

- Require licensees to deliver to a borrower disclosure statements in compliance with Federal Regulation Z. Currently, a licensee must provide a borrower with a statement of the amount and date of the loan and its maturity, the nature of any security for the loan, rate of change, and name and address of the borrower;
- Specifically allow licensees to make loans by mail; and
- Delete language that prohibits a licensee from inducing or permitting a borrower to split up or divide a loan.

Repeals. Finally, the bill would repeal sections of the act that require licensees to file their promotional plans with the commissioner, provide that the persons licensed under Public Act 317 of 1921 (a former regulatory loan act that was repealed and superseded by Public Act 1939) would be covered under the act, and repeal earlier regulatory acts.

MCL 493.1 et al.

HOUSE COMMITTEE ACTION:

The House Committee on Corporations and Finance adopted a substitute for the bill which differs from the Senate-passed version in a number of provisions. Substitute H-2 would establish a regulatory loan ceiling of $8,000 (rather than $15,000) and would raise the annual license fee from $250 to $300. The Senate-passed version would allow licensees to charge a loan processing fee of $25, whereas the House substitute specifies that this fee could not exceed 2 percent of the principal, up to $40. Both versions of the bill would allow a licensee to keep books and accounts at a place different from his or her principal place of business as long as they could be accessed by the commissioner; the House substitute also would require the licensee to pay an examiner's travel expenses if he or she had to travel out of state to examine these records. The House substitute also deleted provisions in the Senate-passed version of the bill to allow licensees to provide credit life insurance on a loan to "co-borrowers," rather than to just one borrower when a loan has co-borrowers (as currently specified under the act). Finally, the House substitute specifies that the business report required by the commissioner every three years would be exempt from the Freedom of Information Act unless the commissioner felt disclosure was in the public's interest.

FISCAL IMPLICATIONS:

According to the Financial Institutions Bureau within the Department of Commerce, the bill could have budgetary implications to the bureau as licensing and examination procedures would be affected. Although the license and examination fee increases specified in the bill would generate more revenue, which would be used entirely for regulating licensees, if there were more new license applicants than expected the bureau would need more money to cover the cost of regulating them. Whether or not additional revenue would be needed, however, could not be determined and would depend entirely on how many new applicants became licensed under the bill. (5-31-90)

ARGUMENTS:

For:

The bill would update the act's provisions regarding interest rate and loan ceilings, record-keeping procedures of licensees, and fees. The act's interest rate and loan ceilings were last changed in 1978 and are now out of date when compared to regulation in other states. Over the last 15-20 years, Michigan's small loan industry has taken a beating as many companies have either fled the state or refused to do business here, primarily due to the Regulatory Loan Act's stringent limits on loan and interest rate ceilings. Thus, the state's pool of available credit to primarily lower income consumers has also dried up. In fact, with the advent of certain "loans by mail," which various Michigan statutes allow by reference even though they are not specifically permitted under Regulatory Loan Act, out-of-state lenders have had a competitive advantage over Michigan's small loan companies. By raising both the interest rate ceiling and loan limit, small loan companies operating in the state could offer consumers higher loans and at interest rates that were more reasonable for the amount of risk involved, and consumers also would have access to more money via larger loans. In fact, raising the amount that could be loaned to $8,000 would still put Michigan's loan ceiling near the middle compared to other states, according to a spokesman from the FIB; this would also apply to the bill's proposed interest rate ceiling. (Some states have no interest rate ceilings whatsoever.) The proposed fee changes also would enable the FIB to raise what it believes should be enough revenue to effectively regulate licensees. Other amendments, such as the provision to specifically allow loans to be made by mail, would simply modernize the act. Substitute H-3 represents the efforts of the FIB, the Consumers Council, and various finance industry groups in negotiating to update the act while also ensuring that consumers and licensees are adequately protected.

Against:

That the type of lender regulated under the act has not thrived in Michigan is to Michigan's credit! Many of the persons who would utilize this type of credit are probably already drowning in debt and don't need any more opportunities for credit. Due to the strong possibility of an economic downturn in the next few years, the state should do everything possible to discourage <u>all</u> persons from taking on more debt — but particularly those in the lower income strata.

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POSITIONS:

The Financial Institutions Bureau supports the bill. (5-31-90)

Household International, which represents small loan companies, supports the bill. (5-31-90)

The Michigan Financial Services Association supports the bill. (5-30-90)

The Michigan Consumers Council does not oppose the bill. (5-31-90)