This revised analysis replaces the analysis dated 8-21-95.

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RAISE INTEREST RATE CEILINGS

House Bill 4614 as enrolled
Public Act 162 of 1995
Sponsor: Rep. Gary L. Randall

House Bill 4616 as enrolled
Public Act 163 of 1995
Sponsor: Rep. Greg Kaza

House Bill 4618 as enrolled
Public Act 164 of 1995
Sponsor: Rep. James M. Middaugh

House Bill 4619 as enrolled
Public Act 165 of 1995
Sponsor: Rep. Tom Alley

House Bill 4621 as enrolled
Public Act 166 of 1995
Sponsor: Rep. Kirk A. Profit

House Bill 4622 as enrolled
Public Act 167 of 1995
Sponsor: Rep. Alvin Kukuk

House Committee: Commerce
Senate Committee: Financial Services

Revised Second Analysis (1-3-96)

THE APPARENT PROBLEM:

Like most states, Michigan restricts banks, savings institutions, and credit unions, as well as non-depository lenders, from charging borrowers an interest rate that exceeds a specific rate, which varies depending on the type of loan made and the kind of financial institution or other business involved in issuing credit. Interest rates on consumer and business loans, including for credit cards, vary widely under different state laws but generally cannot exceed 18 percent annually for consumer loans nor 25 percent for commercial loans. Certain loan types have even lower interest rate ceilings; for instance, rates on new car loans cannot exceed 16.5 percent.

According to the Financial Institutions Bureau and those within the lending community, recent changes made to state and federal laws combined with advances in technology--for example, in telecommunications--have worked to transform the way in which financial institutions issue credit nationwide, particularly for loans involving unsecured credit (e.g., credit cards). In 1994, the Riegle-Neal Interstate Banking and Branching Efficiency Act was enacted to allow commercial banks to move their headquarters from one state to another. Also, a number of states have laws, some passed recently, that allow lenders to charge any rate of interest for both secured and unsecured lines of credit. This has led to a situation where financial institutions headquartered in other states are able to offer various forms of credit to Michigan consumers and businesses at rates that sometimes exceed the caps that apply to Michigan-based lenders, effectively nullifying the state's usury laws. Generally, however, the interest rate most Michigan consumers and businesses pay to borrow money, whether from a Michigan-based lender or one from out-of-state, is well below the ceiling that applies to any of the different types of loans regulated by state laws.

Some people, in fact, believe interest rate caps set by law have no real effect in determining what most people actually pay to borrow money. Rather, people borrow from lenders who offer credit for the least amount of cost; in other words, lenders must compete with one another to attract potential buyers of their "product," money. Under this way of thinking, it is argued that laws restricting the rate of interest lenders may charge borrowers serve no purpose but to drive away credit issuers, and the jobs they create and tax revenue they generate, from Michigan to states with lenient usury laws. As barriers to interstate branch banking fall and competition between states for financial industry jobs increases, some people believe it is time the state adjusted ceilings that apply to interest rates lenders may charge for extending credit.

THE CONTENT OF THE BILLS:

House Bill 4614 would allow regulated lenders to charge, collect, and receive a rate of interest of up to 25 percent per annum on extensions of credit other than credit cards. There would be no interest rate cap for a credit card arrangement. The other bills in the package would amend different acts that cap the rate of interest that may be charged on various types of loans to permit a rate of interest to be charged on such loans up to the levels that would be allowed under House Bill 4614. House Bills 4616, 4618, 4619, 4621, and 4622 are all tie-barred to House Bill 4614.

<u>House Bill 4614</u> would create the Credit Reform Act to permit regulated lenders to charge, collect, and receive any rate of interest or finance charge for an extension of credit up to 25 percent per annum. However, depository financial institutions (banks, savings and loans, and credit unions) could charge, collect, and receive any rate of interest or finance charge for credit card arrangements. The bill provides that, except for fees or charges related to the extension of credit to an individual for "personal, family, or household purposes," the interest or finance charge that was calculated on the principal balance would be computed only on the basis of the unpaid balance. A regulated lender could not make a loan of a type that was not permitted by the act under which the lender was chartered, organized, licensed, regulated, or otherwise allowed to extend credit. (A "regulated lender" would refer to depository institutions and to licensees regulated under the following acts: the Consumer Financial Services Act; Public Act 379 of 1984, which regulates credit card arrangements; the Motor Vehicle Sales Finance Act; the secondary mortgage loan act; and the Regulatory Loan Act; and would refer to a "seller" under the Home Improvement Finance Act.)

<u>Fees and charges</u>. In addition, depository institutions could charge, collect, and receive from a borrower or buyer all fees and charges that were agreed to or accepted by the borrower, which would include those related to making, closing, processing, disbursing, extending, committing to extend, readjusting, renewing, collecting payments on, or otherwise servicing a loan or any occurrence or transaction related to it. For any credit arrangement, all such fees or charges would be considered interest.

Except for depository institutions and as otherwise provided by law, regulated lenders could do any of the following:

* Require a borrower to pay a processing fee in connection with making, closing, disbursing, extending, readjusting, or renewing an extension of credit which could not exceed two percent of the amount of the credit extension;

* Charge a borrower a late fee for an installment payment received after the expiration date of an agreed-upon grace period applicable to the payment. A late fee, however, could not exceed $15 or five percent of the installment payment, whichever was less.

* Charge a fee not to exceed $25 for a check or other payment instrument that was dishonored because of insufficient funds in the account on which the check had been drawn. Such a fee would not be considered interest.

The bill specifically would prohibit regulated lenders from requiring a borrower or lender to pay an excessive fee or charge.

A written agreement made in connection with a credit sale under the Home Improvement Finance Act, the Motor Vehicle Sales Finance Act, or the Retail Installment Sales Act could provide for precomputed interest or its equivalent if any rebate due at prepayment in full was computed according to the actuarial method. Also, any of the following provisions contained in a written document made in connection with a loan to an individual for personal, family, or household purposes would be void and unenforceable: a power of attorney to confess a judgment; a waiver of a borrower's or buyer's rights under the bill, unless otherwise expressly provided by law; and an agreement by a borrower or buyer to pay a penalty, except as allowed by the bill. (Late payment and prepayment charges, however, would not be considered penalties.)

Prohibited activities, legal recourse. Under the bill, a regulated lender could not require as a condition of approving a loan that the borrower contract for one or more additional financial services offered by the lender or a particular service provider designated by the lender. This provision would not prohibit a transaction or requirement that was not prohibited by federal law, and would not apply to a requirement by a depository institution (or an affiliate of one or more depository institutions) subject to federal law.

Upon receipt of a written complaint alleging a violation of the act by a regulated lender, the banking commissioner would have to either 1) investigate the complaint if the lender was chartered, licensed, or regulated by the commissioner, or 2) forward the complaint, if the lender was not subject to the commissioner jurisdiction, to the appropriate regulatory or investigatory authority. In addition, the attorney general, the prosecuting attorney for a county where an alleged violation occurred, or a borrower could bring an action against a regulated lender to do one or more of the following:

* Obtain a declaratory judgment that a method, act, or practice of a regulated lender violated the bill;

* Enjoin a regulated lender who was engaging or about to engage in a method, act, or practice that was a violation under the bill;

* Recover $1,000 and actual damages if the alleged violation of the act had been committed by a regulated lender for a non-credit card arrangement or $1,500 and actual damages if the alleged violation involved any other credit arrangements;

* Recover reasonable attorney fees and costs in connection with bringing an action if the regulated lender was found to have violated the bill's provisions;

* In an action brought by the attorney general or a county prosecutor, recover a civil fine of not more than $10,000 if the regulated lender was found to have willfully and knowingly violated the act and $20,000 if he or she was found to have persistently violated the act.

The bill further provides that, except for certain unintentional or bona fide errors, a regulated lender who violated the bill regarding the extension of credit to a borrower or lender could not recover any interest or other charges in connection with that loan. Borrowers or buyers, on the other hand, could recover reasonable attorney fees and court costs for enforcing this provision or in defending against a cause of action brought by a regulated lender who had violated the bill.

Class action. The bill would authorize the attorney general or a borrower to bring a class action on behalf of persons injured by a violation of the act.

Bona fide errors. A regulated lender would not be liable for a violation of the bill if it had fully complied with the federal Truth-In-Lending Act and showed that a violation was an unintentional and bona fide error, notwithstanding the maintenance of procedures reasonably adopted to avoid the error. ("Bona fide errors" would include clerical, calculation, computer malfunction, programming, or printing errors, but would not include errors in legal judgment with respect to a person's obligations under the bill.) In addition, a regulated lender would not be liable for a violation of the bill if, within 60 days after discovering the violation and before legal action had been taken, it notified the borrower or buyer of the violation and corrected it in a manner that restored, as far as this was reasonably possible, the borrower or buyer to a position he or she would have been in had the violation not occurred. A regulated lender would have the burden of proving whether or not a violation was an unintentional or bona fide error.

The bill would not limit the authority of the banking commissioner, the attorney general, or a county prosecutor to enforce any law under which a regulated lender was chartered, organized, licensed, regulated, or otherwise authorized to extend credit. The bill would not impair the validity of a transaction, rate of interest, fee, or charge that was otherwise lawful.

House Bill 4622 would amend the Retail Installment Sales Act (MCL 445.852 et al.) to remove from the act the current interest rate caps that apply to loans made by persons authorized to issue credit under the act and, instead, would permit them to charge, collect, and receive a rate of interest that did not exceed the interest rate or its equivalent that regulated lenders could charge under House Bill 4614. Under the bill, a retail seller could not require as a condition of approving a credit transaction that the buyer contract for one or more financial services offered by the retail seller or a particular service provider designated by him or her. The bill would not preclude a retail seller from offering a combination of two or more services under prices or terms that were more favorable to the buyer of credit than the prices or terms the services would be offered separately. A retail seller would not be liable for a violation of the act if he or she could show the violation was an unintentional and bona fide error (e.g., a clerical error, computer malfunction, and the like), but an error in legal judgment regarding his or her obligations under the act would not be a bona fide error. A violation that occurred due to a bona fide error could be corrected as provided in the federal Truth-In-Lending Act, and the retail seller would have the burden of proving that a violation was an unintentional and bona fide error.

House Bills 4616, 4618, 4619, and 4621 would amend various acts that regulate the rate of interest that may be charged on loans made by persons regulated under the acts to permit licensees under them to charge, contract for, receive, or collect an interest rate on loans made under the respective acts that would be permitted under the provisions of House Bill 4614 (i.e., "any rate of interest or finance charge . . . not to exceed 25% per annum"). The bills would delete language in each of the acts that establishes interest rate ceilings that currently apply to loans made by licensees under the respective acts. The bills also would delete references to late fees that licensees under the acts currently may assess borrowers who submit late payments and, instead, would authorize licensees to charge late charges as authorized by House Bill 4614. The bills specify that licensees under all of the acts, generally, would be subject to the penalty provisions of House Bill 4614, in addition to penalties specified under each of the separate acts. House Bill 4621, which would amend the Motor Vehicle Sales Finance Act, also specifies that if a motor vehicle were covered by an installment sale contract, the buyer could not transfer equity in the vehicle to another person without the written consent of the holder of the sale contract. Under the bill, the sale contract holder would be authorized to charge a transfer fee of $25.

House Bill 4616 would amend the credit union act (MCL 490.1a et al.); House Bill 4618 would amend the secondary mortgage loan act (MCL 493.51 et al.); and House Bill 4619 would amend the Regulatory Loan Act (MCL 493.1 et al.).

FISCAL IMPLICATIONS:

According to the Financial Institutions Bureau in the Department of Commerce, the bills would have no fiscal impact on the state and local governments. (8-21-95)

ARGUMENTS:

For:

Enactment of the Riegle-Neal Interstate Banking and Branching Efficiency Act last year, which soon will allow commercial banks to branch on an interstate basis for the first time, will hasten the onset of nationwide banking as financial institutions seek to establish a foothold in regional markets throughout the country. Although Michigan-based financial institutions have grown in size and influence since 1985, when the legislature permitted Michigan banks to acquire out-of-state banks, they now must work to remain competitive as the barriers to interstate bank branching fall. Among the competitive disadvantages faced by Michigan-based financial institutions are state laws that cap the amount of interest they are allowed to charge borrowers. Not only are Michigan's usury laws confusing (caps on interest rates that may be assessed for different types of loans range from the single digits up to 25 percent), but evidence suggests they do not really affect what consumers and businesses actually pay to borrow money.

Data provided by the Financial Institutions Bureau (FIB), in fact, indicates that what people pay to borrow money is closely tied to the rates paid for various financial instruments bought and sold in major money markets. For example, interest rates paid on mortgages obtained by Michigan residents over the last decade closely tracked the interest rate on 30-year Treasury bonds, even though Michigan mortgage lenders could have charged any rate of interest on this type of loan. (Interest rate ceilings on mortgage loans were completely deregulated by federal law in 1980.) A similar pattern exists for interest rates paid on other types of loans--although loans with shorter terms tend to follow the rates paid on short-term financial instruments. For instance, rates paid by Michigan borrowers on new-car loans made since the early 1980s not only have risen or fallen in tandem with interest rates paid on similar financial instruments, such as five-year notes; they also have generally remained well below the 16.5 percent cap that applies to this type of loan under Michigan law.

While interest rate caps seem to do little to influence the rates most borrowers pay to obtain credit, it seems that they do in fact work to drive financial industry jobs out of the state and discourage credit-issuing companies from coming here to do business. Individuals employed by Michigan-based banks since the early 1980s testified before the House Commerce Committee that the banks for whom they worked decided to relocate their credit-card operations outside the state primarily because of the state's restrictive usury laws. Few credit cards now carried by Michigan residents have been issued by Michigan-based financial institutions; rather, most state residents (75 percent by some estimates) own credit cards issued by banks located in states with few or no usury restrictions. Thus, not only do the state's usury laws bar Michigan-based lenders from this potentially large consumer market, they fail to do the very thing for which they were created: protect the state's credit consumers. This is because a consumer who is turned down for a loan from a Michigan-based financial institution due to a poor credit history or for other financial reasons often will end up borrowing at higher rates from an out-of-state lender anyway.

By eliminating existing caps on interest rates that apply to credit cards issued by depository financial institutions and raising the cap on loans nondepository institutions could make to 25 percent, the bills would encourage Michigan-based financial institutions to open or expand credit-issuing operations and attract out-of-state lenders into the state. Consumers, however, would probably pay the same or less for credit as competition in the marketplace among an increased number of financial institutions would work to keep rates low. In addition, House Bill 4614 (and House Bill 4622) includes provisions that would protect consumers from certain abusive lending practices, such as requiring a borrower to purchase certain additional financial services in order to qualify for a specific kind of credit; the bills also specify severe fines and penalties for violators and would authorize the attorney general or a borrower to file a class action suit against a lender who violated the bills' provisions. Ultimately, raising interest rate ceilings--or eliminating them entirely, as would be the case for credit cards issued by depository lending institutions--could result in more credit being available for Michigan consumers to use in purchasing automobiles, appliances, and other goods and services via Michigan-based institutions, which is preferable to exporting capital to out-of-state lenders.

Against:

The bills would benefit financial institutions at the expense of the state's consumers by giving depository lenders the freedom to charge whatever rate of interest on credit cards they could get borrowers to agree to, especially lower income people or those who, perhaps due to a lack of financial acumen, do not know how to use credit wisely. In addition, the cap on interest rates for loans made by nondepository lenders would rise to 25 percent, a level that could prove onerous for some borrowers. As data from the FIB shows that rates for different types of loans have never exceeded the caps set for them under the various acts, it could be argued that existing interest rate ceilings have, in fact, worked well to keep the rates people pay for credit low. Further, while it may be true that rates on various loans track interest rates on certain financial instruments--which suggests they generally are not subject to artificial restraints--there is no way to tell what the future holds for interest rates. Some people fear inflation could build in the near future because of a relatively strong economy, and the potential for rising inflation seems greater now than at any time in the recent past considering the depreciation of the dollar against other world currencies in recent months. Lifting the caps that apply to interest rates that could be charged by depository lenders for credit cards, or raising the rate cap that applies to other loans to 25 percent, could expose Michigan's consumers to any abrupt changes in economic conditions that may result from instability in global currency markets.

Response:

Most economists today expect both inflation and interest rates to remain relatively stable over the short term, despite the dollar's weakness of late. Assuming trends remain as they have in recent years, consumers should have no reason to expect that interest rates suddenly will rise. On the other hand, if the legislature should decide to lift the state's interest rate ceilings and current economic conditions dramatically reversed course, it could simply reinstate them later. Whether or not the caps should remain in force, however, ultimately is a matter of state economic and employment growth, not consumer protection.

For:

House Bill 4614 was amended on the House floor to specify that non-depository financial institutions could not make loans at rates in excess of 25 percent, which would be a higher cap than currently applies to these kinds of loans but not as potentially onerous as what was initially proposed for them ("any rate of interest"). Non-depository lenders are small, often transitory operations that are more likely to prey on less-educated, low-income borrowers who seek store credit and used-car loans. And though existing credit limits help state regulators protect a vulnerable segment of the public unsophisticated in seeking the best interest rates available, raising the cap that applies to such loans to a uniform 25 percent would enable these lenders to continue to provide credit to higher-risk borrowers who might not otherwise qualify for any kind of loan, with the stipulation that they could not impose a rate beyond what most people would consider reasonable.

Response:

There is simply no justification for raising the amount lenders could charge on such loans to a "reasonable" level of 25 percent. While raising this cap might not affect most people with fair to good credit histories, it could have a disastrous effect on the most vulnerable segment of society--those in difficult financial situations who occasionally need to borrow money to cover short-term needs. Unscrupulous lenders approached for a loan by such persons could, under the bills, condition the issuance of credit on the borrower's willingness to agree to pay the highest rate allowed, even if the borrower had no previous credit problems. Raising the cap would put the state in the position of abetting such behavior. The legislation should be amended to maintain the lower interest rate caps that currently apply to consumer credit issued by non-depository institutions.

Against:
The House added a provision to House Bill 4614 which would prohibit a regulated lender from requiring a borrower or buyer to pay "an excessive fee or charge." Nothing within the bill, however, defines what would be considered excessive. To prevent lenders from being exposed to unnecessary liability, the bill should clarify what would constitute an excessive fee or charge.

Against:
Four bills that were part of the original package, House Bills 4615, 4617, 4620, and 4625, failed to pass the House even though they would amend acts under which various types of lenders are regulated. These bills would amend the acts regulating, respectively, credit card issuers, home improvement loan makers, banks, and savings and loan associations, and the package of legislation would be incomplete without them.

Response:
These other bills no longer are necessary since amendments added to House Bill 4614 would authorize "regulated lenders," defined to include all the different types of lenders included in the original package of bills, to charge, collect, and receive any interest rate not exceeding 25 percent annually for credit issued. In addition, depository lenders--that is, banks, savings and loan associations, and credit unions--would explicitly be authorized to charge any rate of interest on credit cards. But because of the "most favored lender" doctrine, which permits state- and federally-chartered depository institutions to charge the most favorable interest rate allowed to a competitor, as long as one of the acts regulating depository institutions is amended to allow that type of lender to charge an interest rate permitted under House Bill 4614 (i.e., any rate of interest on credits cards and up to 25 percent on other loan types), the authority would be extended to all of them. House Bill 4616, which would amend the credit union act, passed the House and is still part of the package.

Reply:
As the "most favored lender" doctrine applies only to credit transactions by depository institutions, the two bills that would affect non-depository lenders which failed to pass the House (House Bills 4615 and 4617) are necessary if non-depository credit card issuers and lenders under the Home Improvement Finance Act are to have similar authority to lend at rates of up to 25 percent.