House Legislative Analysis Section
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LIFT INTEREST RATE CEILINGS

House Bill 4614 (Substitute H-4)
House Bill 4625 (Substitute H-1)
Sponsor: Rep. Gary L. Randall

House Bill 4615 (Substitute H-1)
Sponsor: Rep. John Gernaat

House Bill 4616 (Substitute H-3)
Sponsor: Rep. Greg Kaza

House Bill 4617 (Substitute H-1)
Sponsor: Rep. David Jaye

House Bill 4618 (Substitute H-1)
Sponsor: Rep. James Mick Middaugh

House Bill 4619 as introduced
Sponsor: Rep. Tom Alley

House Bill 4620 (Substitute H-1)
House Bill 4621 (Substitute H-1)
Sponsor: Rep. Kirk A. Profit

House Bill 4622 (Substitute H-2)
Sponsor: Rep. Alvin H. Kukuk

Committee: Commerce

First Analysis (5-2-95)

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 removed ceilings that apply to interest rates lenders may charge for extending credit.

THE CONTENT OF THE BILLS:

House Bill 4614 would create the Credit Reform Act to allow depository and non-depository financial institutions in the state to charge, collect, and receive any rate of interest on loans made by them. 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 any rate of interest to be charged on such loans. House Bills 4615 to 4622 and 4625 are all tie-barred to House Bill 4614.

House Bill 4614 would create the Credit Reform Act to permit a regulated lender to charge, collect, and receive any rate of interest or finance charge for an extension of credit. 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. The bill, however, would not permit a regulated lender to 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.)

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. All such fees and charges would be considered interest.

Regulated lenders, except as otherwise provided by law, could do either or both 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;

* 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 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 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 liquidated damages, except as allowed by the bill. (A late payment charge, however, would not be considered a liquidated charge.)

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 actual damages caused by a violation of the act or $250, whichever was greater;

* Recover reasonable attorney fees and the costs in connection with bringing an action under the bill.

However, a regulated lender would not be liable for a violation of the bill if it showed that the 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. A violation of the bill that resulted from a bona fide error could be corrected in the same manner as provided under the federal Truth-In-Lending Act. 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.

House Bills 4615 - 4621 and 4625 would amend the 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"). 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. And finally, 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 4615 would amend Public Act 379 of 1984 (MCL 493.101 et al.), which regulates credit card arrangements; House Bill 4616 would amend the credit union act (MCL 490.1a et al.); House Bill

4617 would amend the Home Improvement Finance Act (MCL 445.1102 et al.); House Bill 4618 would amend the secondary mortgage loan act (MCL 493.51 et al.); House Bill 4619 would amend the Regulatory Loan Act (MCL 493.1 et al.); House Bill 4620 would amend the Banking Code (MCL 487.491); House Bill 4621 would amend the Motor Vehicle Sales Finance Act (MCL 492.102 et al.); and House Bill 4625 would amend the Savings and Loan Act (MCL 491.718).

FISCAL IMPLICATIONS:

The House Fiscal Agency says the bills would have indeterminate fiscal implications for the state and its local governments that would depend, assuming the bills became law, on what lenders regulated under the various acts actually charged these government entities to borrow money after the bills took effect. (4-26-95)

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 loans regulated under different acts, 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. Ultimately, lifting interest rate ceilings would result in more credit being available for Michigan consumers to use in purchasing automobiles, appliances, and other goods and services from 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 lenders the freedom to charge whatever rate of interest 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. 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 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. Removing interest rate ceilings established in state law could expose Michigan's consumers to any abrupt changes in economic conditions that may result from instability in the world's 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.

Against:
While it may be appropriate to eliminate interest rate caps that apply to loans issued by depository financial institutions, which are subject to more scrutiny and higher lending standards, the same cannot be said for caps that apply to loans issued by non-depository financial institutions. Non-depository lenders are small, often transitory operations that regularly prey on less-educated, low-income borrowers who seek store credit and used-car loans. Existing credit limits give state regulators a tool for protecting a vulnerable segment of the public unsophisticated in seeking the best interest rates available. It may be true that lifting interest rate caps would benefit most people who have steady jobs and decent credit histories. However, those who through no fault of their own become unemployed or for some other reason face a sudden financial crisis could be exposed to even worse economic circumstances if, under the bills, they borrowed from a predatory lender to cover a short-term need only to find themselves later burdened with an insurmountable debt load resulting from a high-interest loan. The legislation should be amended to maintain interest rate caps that currently apply to credit issued by non-depository institutions.

POSITIONS:

The Financial Institutions Bureau supports the bills. (4-26-95)

The Michigan Bankers Association supports the bills. (4-26-95)

The Michigan Credit Union League supports the bills. (4-26-95)

The Michigan League of Savings Institutions supports the bills. (4-27-95)

The Michigan Retailers Association supports the bills. (5-1-95)

Household International Companies, which deals in consumer credit, supports the bills. (4-27-95)

NBD, Michigan's largest state-chartered bank, supports the bill. (4-26-96)

Old Kent Bank supports the bill. (4-26-95)

Michigan National Corporation supports the bills. (4-26-95)

The Michigan Consumers Federation opposes the bills. (4-26-95)

The Michigan State AFL-CIO opposes the bills. (5-1-95)

The UAW opposes the bills. (4-26-95)

Michigan Legal Services, which helps low-income people secure credit, opposes the bills. (4-27-95)

Legal Services of Eastern Michigan opposes the bills. (4-26-95)