House
Legislative
Analysis
Section

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REGULATORY LOAN ACT

Senate Bill 111 with House committee amendments
First Analysis (3-21-91)

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

THE APPARENT PROBLEM:

The Regulatory Loan Act of 1963 regulates "non-depository" financial institutions (a group of institutions which does not include state and federal banks, credit unions, and savings and loans) in the business of offering small loans of up to $3,000 to consumers. The act was last substantively amended in 1978 to increase the interest rate and loan ceilings. Since 1978, many restrictions within the financial services industry have been removed in other states to allow these kinds of lenders to offer higher loans at higher interest rates to consumers. The consumer finance industry in Michigan believes that the act is outdated and at its request legislation has been introduced that would update both the interest rate and loan maximums, as well as easing some of the other regulatory burden on the industry.

In addition, the Financial Institutions Bureau (FIB) in the Department of Commerce, which licenses regulatory loan establishments and conducts financial examinations of the lenders, reports that existing fees do not cover its expenses for conducting the required examinations. At its request, changes in fees, as well as in certain other of the act's outdated requirements, have been proposed.

THE CONTENT OF THE BILL:

The bill would amend the Regulatory Loan Act to:

* increase the regulatory loan ceiling from $3,000 to $8,000, the application fee for a regulatory loan license from $150 to $300, and the annual license fee from $250 to $300;
* establish an examination fee;
* provide for biennial, rather than annual, examinations of licensed lenders;
* provide for loan processing and check handling fees; and
* change the act's provisions concerning disclosure statements, credit life insurance, and interest rates.

The bill would take effect October 1, 1991.

Examinations. Currently, the commissioner of the Financial Institutions Bureau is required to examine the affairs, business, office, and records of each licensee to the extent that they pertain to any business licensed under the act. The bill would delete this provision and require instead that at least once during every two-year period the commissioner examine a licensee's books, accounts, records, and files. The bill would allow the keeping of records by electronic data processing methods, and would allow books and accounts to be kept at a location other than the licensee's principal place of business, so long as they were made available to the commissioner upon request and the licensee paid the actual and reasonable travel expenses if the examiner had to travel out-of-state.

Under the bill, the annual license fee would no longer cover examinations. Instead, licensees would have to pay an examination fee that would be based on a rate of not less than $20 or more than $40 per hour for each examiner engaged in an examination. Each examination fee would be invoiced upon completion of the examination and would be due and payable upon receipt of the invoice by the licensee. The licensee could not be required to pay for more than one examination fee in a calendar year.

The fees would be paid into the state treasury and credited to the Financial Institutions Bureau. (Currently, any fees collected under the act are credited to the general fund.) In addition, the bill specifies that the commissioner could take court action to recover any fees a licensee failed to pay.

Interest rate. The act currently allows a licensee to charge a monthly interest fee of up to one-twelfth of either (a) 18 percent per year of the unpaid principal balance up to the regulatory loan ceiling; or (b) 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 regulatory loan ceiling.

The bill would delete these provisions and provide for an interest rate of up to 22 percent per year on the unpaid balance. The rates charged under the bill also would be fixed and could not be increased during the term of the loan contract. The rate for a car loan could not exceed the rate provided for that class of vehicle in the Motor Vehicle Sales Finance Act. The bill would delete requirements that loan charges be paid only as a percentage per month of the unpaid principal balance, and that a licensee who advertises aggregate, combination or graduated rates 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.

Fees. The bill would allow lenders to charge a loan processing fee of up to 2 percent of the principal or a maximum of $40 for each loan made and include the fee in the loan principal and would prohibit licensees from trying increase their loan processing fees in a number of ways.

The bill would allow a licensee to charge a handling fee of $5 and the amount of the actual charge made to the licensee by a depository institution for the return of an unpaid and dishonored check, draft, negotiable order, or similar instrument given to the licensee in full or partial repayment of a loan.

Void Loan Contract. The act currently specifies that if, in the making or collection of an otherwise valid loan contract, an action that constitutes a misdemeanor under the act is taken, the contract is void and the lender cannot collect or receive any principal, interest or charges, unless the action is a bona fide clerical error.

The bill would change this language to say instead that someone who entered into an otherwise valid loan contract would be barred from recovering interest or principal if a misdemeanor were committed in the making or collection of the contract unless the misdemeanor were the result of an accidental, bona fide, or judicially determined justifiable error. A court could provide for recovery of the principal if the court 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:

* Remove the requirement that before granting a license or allowing a licensee to relocate, the commissioner must find that allowing an applicant to engage in the lending business or relocate would "promote the convenience and advantage of the community".
* Delete the prohibition against allowing a business to move outside of its original county under the same license.
* Allow licensees to provide credit life insurance for co-borrowers. (The act currently restricts licensees to offering credit life to only one borrower even if there are co-borrowers.)
* Require licensees to deliver to the borrower disclosure statements in compliance with Federal Regulation Z. Currently, the act specifies that the licensee must provide the 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 charge, and name and address of the borrower.
* Change from February 15 to March 15 the filing deadline for the reports licensees must submit to the commissioner every three years. The bill also would exempt reports from disclosure under the Freedom of Information Act unless the commissioner found that such disclosure would be in the public interest.
* Clarify that the act's prohibition against licensees' transacting business or making loans under another name or at any other location in Michigan than that named in the license unless it also is an office of the licensee would not prohibit a licensee from transacting business or making a loan by mail.
* Delete language prohibiting a licensee from inducing or permitting a borrower to split up or divide a loan.

Repeal. The bill would repeal sections of the act that require licensees to file their promotional plans with the commissioner; provide for the "grandfathering in" of persons licensed under Public Act 317 of 1921, a former regulatory loan act that was repealed and superseded by Public Act 21 of 1939; and repeal a section that repealed earlier regulatory acts.

MCL 493.1 et al.

HOUSE COMMITTEE ACTION:

The House Committee on Corporations and Finance amended the bill to reinstate language in section 13 (2) that would prohibit licensees from inducing or permitting someone to become obligated ("directly or contingently, or both") under more than one loan contract at the same time.

FISCAL IMPLICATIONS:

According to the Senate Fiscal Agency, the bill would generate an additional $3,000 from the increase in the annual license fees and could save the state $6,750 annually in examination fees. (3-4-91)

ARGUMENTS:

For:

The bill would update the act's provisions concerning interest rates, loan ceilings, record-keeping procedures for licensees, fees, and disclosure statements. Raising the interest rate ceiling and loan limit would enable small loan companies to offer consumers larger loans and loans at interest rates that were more reasonable for the amount of risk involved. Consumers, therefore, would have greater access to credit, and could secure credit on terms they could find more convenient or favorable to them than other sources of credit.

Against:

By raising the interest rate for small loan companies, the bill would effectively raise the interest rate for most lenders since the federal "most favored lender" provisions allow depository financial institutions to charge the most favorable lending rate provided for lenders under state law. Thus, if banks, credit unions, and savings and loan institutions were dissatisfied with the maximum interest rates they are allowed to charge under their own enabling legislation, they could take advantage of the rates specified in the bill for nondepository institutions.

Response: The bill would not automatically result in increased interest rates for all types of loans since depository financial institutions may use the most favored lender rate only if they comply with all of the substantive regulations concerning loans made at that interest rate, including any consumer protection regulations. Further, in many cases, the regulations specified in the bill and the Regulatory Loan Act are not as favorable to the other institutions as those specified in the Banking Code and other similar statutes. For example, credit card companies and institutions offering home equity loans and lines of credit would not be likely to use the regulatory loan interest rate because credit cards offer open-ended credit and, according to the FIB, the loans made under the act must be for a specific amount up to the prescribed maximum amount. Further, banks and other financial institutions probably would not use the regulatory loan interest rate since they are allowed to charge reasonable fees for processing loans, while lenders governed by the Regulatory Loan Act would be limited by the bill to charging maximum processing fees of 2 percent of the principal of the loan up to $40.

POSITIONS:

The Department of Commerce supports the bill. (3-20-91)

The Michigan Consumers Council does not oppose the bill. (3-20-91)