House Legislative Analysis Section
Washington Square Building, Suite 1025
Lansing, Michigan 48909
Phone 517/373-6466

GENERAL USURY CEILING

House Bill 4706 with committee amendments
First Analysis (6-7-88)

Sponsor: Rep. Thomas Power
Committee: Corporations and Finance

THE APPARENT PROBLEM:

The usury act, Public Act 326 of 1966, imposes an annual interest rate limit of seven percent on written loans. Numerous exceptions have been made to this limit, with the result that the ceiling generally applies only to loans (other than real estate and business loans) made by individuals who are not in the business of extending credit. Regardless of its limited applications, the general usury ceiling is widely considered to be unrealistically and unfairly low, given today's market interest rates. It has been suggested that the general usury limit be increased to a more reasonable figure.

THE CONTENT OF THE BILL:

The bill would increase the general usury interest rate limit on written loans from 7 percent to 12 percent per year, and specifies that this rate would include all finance charges as defined in the federal Truth in Lending Act. (The 5 percent limit on unwritten loans would be retained.) The 12 percent ceiling would apply in all cases in spite of other provisions in the act requiring a lower rate of interest.

MCL 438.31

FISCAL IMPLICATIONS:

According to the Financial Institutions Bureau of the Department of Commerce, the bill would not affect state expenditures. (6-2-88)

ARGUMENTS: For:

The bill would increase the general usury limit from 7 percent per year to a more reasonable 12 percent. This rate is closer to market rates and would be a more appropriate ceiling.

Against:

The initial intent of the bill was to increase the maximum allowable interest rate in written contracts by private individuals who are not in the business of extending credit. Although the concept to raise the maximum allowable rate in these types of contracts is generally considered appropriate — since current market interest rates are substantially higher than the seven percent ceiling found in the act — there are some who feel the bill would create a greater loophole for various unregulated lenders covered elsewhere in the act. The bill should be amended to specify that the provisions within the bill apply only to those who deal in written contracts in a limited capacity, such as those between family members or friends, or for those who deal in a limited number of written contracts each year.

For:

The bill specifies that the computation of interest rates would include all amounts defined as the finance charge in the federal Truth In Lending Act. This provision would ensure that any legislated limit could not be evaded by charging unreasonably high fees in addition to the agreed upon interest rate.

Against:

Finance charges generally are added to the interest rate cost of a loan to cover the lender's expenses for services rendered beyond that of loaning funds (e.g., for paperwork). Other statutes regulating loans do not include finance charges in the computation of interest rates, and the usury act should conform to those laws.

Against:

By specifying that the 12 percent ceiling would apply in all cases despite other provisions in the act requiring lower interest rates, the bill would nullify the 11 percent ceiling applicable to a number of other contracts, including land contracts, seller-financed second mortgage contracts, second mortgage loan contracts made by licensed residential builders or real estate brokers, or an extension of credit secured by a junior lien in a mobile home contract. If such an interest ceiling increase in these types of contracts is warranted, the bill should explicitly say so by amending sections of the act pertaining to these; otherwise, the bill would create some uncertainty and could produce undesirable results.

Response: Raising the maximum allowable interest rate for these types of contracts, as the bill would do, does not necessarily mean sellers of these types of contracts will actually be able to get this higher rate. In fact, the current market rate for interest on land contracts is 10 percent. The bill would simply permit those who sell these contracts the flexibility to require a higher interest rate if the market rate for these should change.

Against:

While 12 percent may seem a reasonable figure now, it should be noted that market interest rates have been considerably higher in recent years than they are at present. The bill may be preferable to current law, but raising the ceiling to a modest 12 percent would be only a minor improvement.

POSITIONS:

The Financial Institutions Bureau supports the bill. (6-1-88)

The Michigan Bankers Association supports the bill. (6-1-88)

The Michigan Association of Realtors supports the concept of the bill. (6-1-88)

The Michigan League of Savings Institutions supports the bill. (6-1-88)

The Michigan Consumers Council opposes the bill. (6-1-88)