REPORT TO
THE JOINT STANDING COMMITTEE ON
BUSINESS AND COMMERCE
OF THE 112TH LEGISLATURE

ON THE QUESTIONS OF
THE AVAILABILITY OF CREDIT TO PERSONS OF SMALL MEANS
IN THE STATE OF MAINE
AND
THE PROPRIETY OF RETAINING THE SO-CALLED 37 MONTH RULE
IN THE LAWS OF THE STATE OF MAINE

Prepared by

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November, 1986
Revised November 12, 1986

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November 12, 1986

TO: Senator Beverly M. Bustin, Chairwoman
Representative Joseph C. Brannigan, Chairman

Joint Standing Committee on Business & Commerce

FROM: Robert A. Burgess, Superintendent RAB

RE: Conveyance of Report in accordance with Study Request of April 14, 1986.

Attached hereto is the Bureau of Consumer Credit Protection's Report to The Joint Standing Committee on Business and Commerce relating to the questions of the Availability of Credit to Persons of Small Means in the State of Maine and the Propriety of Retaining the So-Called 37 Month Rule in the Laws of the State of Maine.

In preparing this Report we secured as much relevant evidence on the questions presented as time would allow. In light of the very subjective nature of the first of the two questions presented and discussed, our data are circumstantial evidence suggesting what the true answer might be. Short of an enormously expensive statewide poll of consumers this approach is the best we could devise considering the time and money available.

Nevertheless, we believe the Report is responsive to your needs and hope that the Committee finds it helpful in its deliberations on this issue.

RAB/rlb

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INTRODUCTION

On October 7, 1967 L.D. 986 became law. Among other things it added the so-called "37-month rule" to Maine law, and for this it is most remembered. The "37-month rule" was the legislative response to the perceived widespread problem of continually renewing high interest rate loans by finance companies, such that the debtor remained constantly in debt. This was regarded as a highly abusive practice, one that was both unfair and which was driving consumers into bankruptcy.

Within a few years of its enactment, and after an unsuccessful attempt to modify the "37-month rule", most finance companies left the State of Maine. Because of the close relationship in time between the enactment of L.D. 986 and the departure of the finance companies, the "37-month rule" is generally regarded as being the <u>exclusive</u> cause of the demise of the small loan industry in Maine. With nearly twenty years of historical dust between then and now it is also assumed by most casual observers today that the practice of continually refinancing loans was also the exclusive problem of the time. With those two premises in place it is further assumed that if the "37-month rule" were eliminated or significantly modified finance companies would rush back into Maine and that the abusive practices would begin again. It is argued that such a change is both undesirable and unnecessary because credit unions have filled the void left by finance companies, providing adequate credit to Maine consumers, at reasonable rates and with little or no consumer abuse.

This study was prompted by consideration of L.D. 2043 (See Appendix 2) by the Second Regulation Session of the 112th Legislature. Sponsored by Senator McBreairty, the bill was in response to concerns of inadequate credit availability in Aroostook County. One stated purpose of Maine Credit law (9-A M.R.S.A. §1-102(2)(A)) is to assure "an adequate supply of credit to consumers." The bill was premised on the belief that current Maine law dissuaded full participation in Maine's consumer credit marketplace by all types of financial service companies, thereby restricting credit availability to some segments. The bill proposed to significantly modify the 37-month rule such that finance companies might find it again attractive to do business in Maine. Being concerned that such a dramatic change in Maine law should not be accomplished without more detailed analysis, the Committee decided to study the issue, and requested both the Bureau of Consumer Credit Protection and the Office of Policy and Legal Analysis to collaborate in preparing such a study.

The end purpose of this Study is to try to determine if there is an adequate supply of consumer credit in Maine and if modification of the 37-Month Rule is warranted. In examining these issues the Study looks at the situation that gave rise to enactment of the 37-Month Rule; the changing role of financial institutions in the State; the degree to which credit needs of our marginally creditworthy citizens are being served; changing societal attitudes about debt; the level of consumer credit regulation and protection today versus twenty years ago; and finally, the experiences of other states in the regulation of finance companies.

The Study concludes by offering some possible legislative alternatives to the present statutory scheme.

TEXT OF THE "37-MONTH RULE"

The current version of the 37-Month Rule is found in subsection 3 of §2-308 of Title 9-A, the Maine Consumer Credit Code:

> 3. No consumer loan on which the annual percentage rate disclosed is greater than 18% may provide for a greater rate than 8% per year on the unpaid balances of the principal remaining unpaid at the expiration of 37 months on the original loan, including any additional amounts borrowed, any deferral, renewal, refinancing, consolidation or extension of the contract made within the 37 months; and thereafter the unpaid principal balance shall not be directly or indirectly renewed or refinanced by the lender who made the loan, nor shall that lender grant any additional loan to the consumer until the unpaid balance has been paid in full.

EXECUTIVE SUMMARY

This Report was prepared pursuant to a legislative Study Request of the Joint Standing Committee on Business and Commerce to evaluate the availability of credit to persons of small means in Maine as well as the wisdom of repealing the so-called "37-Month Rule."

The study is divided into five major sections. Section I covers the historical and legislative background to the enactment of the "37-Month Rule" in 1967; Section II examines the availability of credit in Maine at that time and today; Section III relates the experiences of other states in regulating the consumer finance industry in their respective states; Section IV discusses the consumer finance industry and its role in credit today; and Section V presents current statutory protections and legislative alternatives to prevent the recurrence of the finance company abuses that, in part, led to the enactment of the 37-Month Rule.

The methodology followed in the studies leading to the Report was incapable of producing a definitive answer on the question of credit availability to Maine consumers. Time and resources did not permit possibly more conclusive analysis. Nevertheless, significant findings of the Report include the following:

1. The practice of continuously refinancing high rate loans, at which the 37-month rule was addressed, was but one of several serious abuses perpetrated by <u>some</u> finance companies on consumers. The other problems, which included unfair insurance sales practices and debt collection practices were remedied by other laws, and those protections remain in effect today. The gravity of the abuse was in part attributable to the unstaffed nature of, and the lack of enforcement by, the principal state regulatory agency at the time.

2. There was not universal distaste for the small loan industry. On the contrary, while there was concern about abuses, there was clear recognition of the important role loan companies played in the overall credit marketplace in Maine, as evidenced by the close votes in enacting the 37-Month Rule. Except for a very small minority, there was no advocation for the elimination of the small loan industry from Maine.

3. The 37-Month Rule was repealed by the Legislature in 1969, only two years after its enactment. A gubernatorial veto reinstated the law, however. The Governor's veto was based on the belief that (a) the 37-Month Rule should be given a chance to work before it was modified and (b) the Rule would not cause the demise of the small loan industry.

4. The Governor's judgment, with hindsight, was wrong. The 117 finance company offices in 1967 dwindled to 20 in 1972. Loan outstandings fell from $31 million in 1967 to less than $11 million in 1972.

5. Three principal theories underlay the enactment of the 37-Month Rule: (a) that abnormal profits were being made by finance companies; (b) that improvident loans were being made to uncreditworthy borrowers; and (c) that long term indebtedness to finance companies was directly linked to consumer bankruptcy. Studies by Professor George Benston of the University of Rochester in 1972 and 1974 disproved these theories.

Research of more recent scholarly writings has found none that reveals a direct causal link between consumer indebtedness to finance companies and bankruptcy.

6. The demise of finance companies produced a tangible decrease in the availability of credit to certain consumers. Professor Benston's study indicated that 50% of "good" former finance company customers were unable to find alternative sources of credit.

7. Maine financial institutions are not interested in making small loans. Minimum loan sizes at Maine commercial banks averaged $744; at savings and loans, $800; and at savings banks, $957. Customers seeking smaller amounts were offered credit cards, but not all such customers meet the higher credit standards necessary to obtain an open-end product.

8. While the number of branches of financial institutions has increased since 1970, the number of actual institutions in Maine has fallen a significant 35%, from 306 to 196.

9. Credit unions have not filled the void left by finance companies. Only 35% of the population are members of credit unions, and loan lending limits, as well as minimum membership (or employment) periods are characteristics of some that further restrict lending. The number of credit union locations (and the number of credit unions) has declined since 1970. While assets and loan volumes at credit unions have grown dramatically since 1970, the percentage of credit union assets lent to members has steadily declined. At federal credit unions loan volume outstanding compared to assets was 71% in 1970, dropping to 62% in 1985. At state chartered credit unions, loan outstandings to assets was 88% in 1970, dropping to 63% in 1985.

10. Most of the estimated 7,000 retail businesses in Maine do not offer credit. In total, 816 locations offer credit to finance the goods and services sold. In most cases, such credit is "indirect" credit provided by sales finance companies. It is estimated that fewer than 100 businesses provide direct, internal financing. Sixty-two percent (62%) of such credit is provided by five large stores.

11. The perception of 33% of a survey group of 100 small Maine merchant creditors was that not all of their creditworthy customers were receiving adequate credit. Eighty-eight percent (88%) of the respondents who indicated past experience with finance companies in Maine said such experience was favorable. That same group supported the return of finance companies to Maine.

12. Public perception of debt appears to have changed, as evidenced by the growth of credit cards. An estimated 228,000 Maine households (out of a total of 400,000) hold a VISA or MasterCard; 86,000 carry a balance from month to month and 45,000 pay only the minimum required each month.

13. An increasing percentage of these cards are issued by out-of-state banks over which the State of Maine has questionable authority.

14. The consumer finance industry today ranges from the corporate giants such as Beneficial to the one branch "Mom & Pop" type operations in the small towns of America. At the end of 1984, the consumer financce companies held $96.7 billion in installment credit outstanding. Survey data of a sample of 62 finance companies indicated that 34.6% of loans

made were made to families with household incomes of $15,000 or less (35.9% of all US households).

15. Anecdotal information relating to consumer perception of finance companies demonstrates the rationality of choosing a more expensive credit source: factors such as quicker services and "friendliness" are often cited.

16. Of 42 states responding to a Bureau survey, none reported continuous refinancings, such as were experienced in Maine, as a problem. The most common problems were "packing" insurance products into loans and failing to properly rebate unearned insurance premiums in prepaid transactions. Responding states oversaw 12,600 finance company offices and reported only 32 formal administrative actions against such companies (including license revocation or suspension) in the last three years.

17. No other state had a provision comparable to Maine's 37-Month Rule. Nine states used a punitive interest-after-maturity law to deal with the problem of chronically delinquent loans.

18. The Bureau has offered a legislative proposal involving an interest-after-maturity law, rulemaking authority, and administrative license suspension power as a suitable substitute for the 37-Month Rule. When combined with the other consumer protections in the Maine Consumer Credit Code, and other consumer laws, the Bureau feels confident in concluding that the problems of the mid-1960's would not recur if finance companies were to return to Maine.

19. Based on the foregoing, the Bureau sees no continued justification for a legislative structure that results in the categorical exclusion of finance companies from the Maine consumer credit marketplace.

SECTION I

HISTORICAL AND LEGISLATIVE BACKGROUND TO THE ENACTMENT OF THE "37-MONTH RULE"

A. PROFILE OF THE SMALL LOAN INDUSTRY AND ITS REGULATORS

1967 was the last good year for finance companies in Maine. At that time there was a total of 116 offices throughout the state, representing 28 different companies (17 national, and 11 local). (See Appendix 3 for locations.) Thirteen of the offices were local companies' offices, while the remaining 103 represented the national corporations. The dollar volume of loans outstanding was $31 million.[1] Collectively, these companies paid $1.8 million in salaries and $90,000 in state taxes.[2]

Just five years later, in 1972, the dollar volume of loans outstanding had dropped to $10.8 million. An even greater drop in licensed locations and number of finance companies occurred during that same period: only 20 offices remained, five of which were local. The number of companies doing business in Maine dwindled to a total of nine, four of which were local.

The dramatic change was brought about by the enactment of the so-called "37-month rule" in 1967, which effectively prevented finance companies from renewing high rate loans if the repayment period would extend beyond 36 months after the original inception of the loan. (For a more detailed discussion of the legislation see subsection B, infra.) Considering that an estimated 62% of the loans made were renewals,[3] it is easy to understand why such a provision sounded the death knell for the small loan industry in this State.

The small loan industry prior to the enactment of the 37-month rule, and beyond (until 1975), was regulated by the Division of Personal and Consumer Finance within the Department of Banks and Banking. In addition to administering the Small Loan Law and the Large Loan Law, the Division also enforced the Home Repair Financing Act, the Insurance Premium Finance Company Act, the Motor Vehicle Sales Finance Act and miscellaneous other laws (later to include the significant Truth-in-Lending Act (1968)) affecting retail creditors. When all such entities subject to the Division's jurisdiction were considered, there were probably more than 1,000. Yet during the period prior to, and including, 1967, the Division was served by only one field examiner and a Director. After all the attention the alleged finance company abuses generated, additional legislative appropriations brought staff size up to six, four of whom were field examiners, by the summer of 1969. By that time, however, the 37-month rule had been enacted (and reaffirmed by a Gubernatorial veto) and the decline in the industry was well on its way. If better enforcement of law had been a viable alternative to the sweeping legislation represented by the 37-month rule, the expansion of the Division's staff came a little too late.

B. CONTINUOUS REFINANCINGS AND THE 37-MONTH RULE

The original 37-month rule was enacted as an amendment to 9 M.R.S.A. §3081, pursuant to L.D. 986, P.L. 1967, c. 474, §5. That amendment provided, in relevant part, as follows:

> No contract or loan made under chapters 281 to 289 shall provide for a greater rate than 8% per year simple interest on the principal balance remaining unpaid at the expiration of 36 months on the original loan, including any additional amounts borrowed, any renewal, refinancing or extension of the contract made within such period; and thereafter, such unpaid principal balance shall not be directly or indirectly renewed or refinanced by the lender who made such loan, nor shall such lender grant any additional loan to any such borrower until such unpaid balance has been paid in full.

The gist of the legislation, which has been carried forward into 9-A M.R.S.A. §2-308(3), was to prohibit high rate loans (above 18%) from extending beyond 36 months, either through their original payment schedule or through extensions or refinancings. The law also prohibited the same lender from making additional loans to a consumer who had not yet paid off a loan that had run beyond the 36-month period.

As mentioned in other documents reviewed by the Business and Commerce Committee prepared by the office of Policy and Legal Analysis (see Appendices 4 and 5) there was an extreme division of economic and philosophical theory among detractors and supporters of the small loan industry. Detractors saw finance companies as not responding to demand for funds, but creating it, and doing so among ill-informed consumers who were not aware of alternatives and who were of marginal creditworthiness. Their principal technique, critics argued, was to get a customer in debt and keep him there through continual loan renewals and refinancings. The remarks of Senator Mills in the Senate debate on adoption of L.D. 681 in 1967 are representative:

> ... you can't classify these people with the banks. You can't say that they should have the same privileges that the banks do. Their motives are wrong. They are panderers of debt. They are merchants of debt.

> ... I don't think it is a good thing for the State to have eight or ten of them in Augusta, or five or six in Skowhegan, and I will explain why. They are not like banks. They are not doing a banking business. They are not in there providing a service to people who need money in trouble. They are pandering these loans. They are pushing these loans onto people who shouldn't have them. They are putting money on the kitchen tables and urging additional loans, urging new rewrites.

> A typical example of one of the large companies operating in this State is the following: Right after Thanksgiving a call would come in from the district supervisor and you can recognize this as coming directly from one who knew it and had participated in it -a call would come in from the district supervisor and he would say "You have got 400 accounts. Every one of those 400 accounts is good for an additional $100; now get it out." The banks don't do that. The banks don't send out a letter asking "Can't you use an additional $100 before Christmas". Then, if the letter fails, a telephone call to the wife at home, "Couldn't you and your husband use an additional $100 before Christmas?" And then, if that doesn't work, one of the employees in the office drops around, and the $100 is put on the kitchen table. Now, if that is something we want to sponsor and encourage, go along and cater to this small loan lobby, give them what they want....[4]

The practices complained of principally involved continuous refinancings of existing debt, sometimes mistakenly called "flipping." ("Flipping" is, in fact, the conversion of a credit sale (installment) contract a loan company would acquire from a retail merchant by assignment into a loan.) As noted above in subsection A, an estimated 62% of finance company loans were refinancings. While refinancings were technically voluntary, they were usually the product of aggressive solicitation by finance companies, and consumers rarely appreciated the financial consequences of refinancing. Because of the application of the Rule of 78's to the calculation of unearned finance charges (which allowed the lender to keep a disproportionately large amount of payments made as earned interest) and insurance premiums, lenders could earn an even higher return on refinanced transactions than if the loans had gone to maturity. (For a detailed analysis of the incentives for, and practices followed, in refinancing and flipping loans, see Appendix 6.) Unscrupulous lenders might not refund unearned insurance premiums and could also build into the refinanced debt questionable late charges and penalties. By adding new money, at the same high rate, but stretching out the maturity of the obligation, the lender could lower the consumer's monthly payments, which was very appealing to the consumer. The financial consequences to him were, however, significantly increased finance charges because of (1) the application of the Rule of 78's to the refinanced loan and (2) the extended term of the new loan. Whether the loan was for a "socially acceptable" purpose or not, the net result was that the consumer was deeper in debt.

Refinancing also provided loan office managers with a convenient way to clean up delinquent accounts to look good to the home office. An account that was in arrears might simply be refinanced with a little new money to bring the account current.

The 37-Month Rule was designed to prevent such abuse by effectively limiting all high-rate loans, including any renewals or refinancings, to a 36-month maturity. Thereafter, the rate would drop to 8%. Such a penalty would deter the complained of practice by permitting a consumer to pay off an existing debt before assuming new or greater debt. Legislators were unsympathetic to and unpersuaded by finance company arguments that repeated business (through renewals and refinancings) were necessary to their economic survival.

C. OTHER CRITICIZED PRACTICES OF FINANCE COMPANIES

In trying to understand the role, and practices, of finance companies in Maine in the early 1960's one must take note of several important distinctions from the situation today. The most significant difference, of course, is the fact that the notion of consumer rights was almost entirely absent. Certainly there were laws on the books attempting to strike some kind of balance and fairness as to borrowers, in the case of credit and banking, and insureds, in the case of insurance. Such "protections" were, however, the product of informed regulators and legislators and were not the result of grass roots demands for such protections from consumers. There was not the pervasive sense among consumers then, as there clearly is today, that they "have rights" and that there are consumer protection agencies in government designed to help the average person. Those notions and attitudes are modern creations, evolving out of the 1960's and 1970's and spurred on in their evolution, in part, because of some of the egregious conduct of finance companies against consumers.

More particularly, in the mid - 1960's:

- **there was no Truth-in-Lending Act:** credit costs were disclosed in several different ways, some of which were highly misleading, making comparison shopping virtually impossible. (State and federal Truth-in-Lending Acts were enacted in 1968);

- **there was no consumer protection agency in Maine:** there was no Consumer and Antitrust Division in the Attorney General's Office and no Bureau of Consumer Credit Protection (this office was not created until 1975);

- **there were far fewer protections even in cases where there was regulation:** for example, the Rule of 78's was the principal method of calculating unearned finance charges in precomputed loans that were paid off early, such as in the case of a refinancing or a flip;

- **there were no laws providing for the consumer's attorneys' fees to be paid:** laws providing that the creditor will pay the consumer's attorneys' fees if the consumer successfully proves that the creditor violated the consumer's rights in a particular transaction, did not yet exist. Thus, to the extent there were "consumer protection" laws on the books, consumers had to bear the legal expense of exercising them themselves, which made such remedies unattractive to most consumers.

In short, many of the consumer laws we are aware of today, and perhaps take for granted, were either non-existent or else in a very rudimentary form, in the 1960's. The opportunities for unfair dealing and consumer abuse were far greater then than they are today.

In the area of small loan lending, several abuses started to come to light in the mid-1960's that were undoubtedly a product of the non-protective consumer environment that existed at that time. Although the focus of this study is on the 37-month rule which addressed the practice of continuous loan refinancings, such practice was only one of a number of unfair practices focused on. They included:

Unreasonably High Small Loan Rates: In 1966 the Legislature enacted an emergency bill (L.D. 1619) that lowered the maximum small loan interest rates, and the amounts on which they could be charged. The original stepped rate system was 36% on loans up to $150; 30% on loans between $150 and $300; and 18% on loans above $300 up to $2,500. The revised rate system allowed only 30% on loans up to only $100; 24% on loans between $100 and $300; and 9% on loans above $300 up to $2,500. Bills seeking to make such changes had been introduced since at least 1963, but had failed to be enacted.

<u>Abusve Credit Insurance Practices:</u> In 1967 the Legislature enacted L.D. 681, the principal purpose of which was, based on legislative debate, to correct abusive credit insurance practices. At the time lenders were able to sell all forms of credit insurance - life, accident and health and property insurance (household goods insurance) - at whatever rate they chose, regardless of what their premium was. In Senate floor debate by Senator Mills numerous cases were cited in which insurance of all kinds had been "packed" into loans of unsuspecting consumers, and financed, such that in some cases, the insurance charges earned by the finance company exceeded the finance charges earned. The insurance product most abused was accident and health insurance. L.D. 681 prohibited the sale of such insurance on very small loans, or loans of relatively short duration (those provisions remain in current law, 9-A M.R.S.A. §4-104(3)) and established new reporting requirements for the sale of all forms of credit insurance.

<u>Abusive Debt Collection Practices:</u> While some members of the Legislature characterized finance company operating procedure as "lend with a smile and collect with a goon squad,"[5] the objection to debt collection practices lay not so much with finance companies themselves as with the legal environment in which debts could be collected. In this pre-<u>Sniadach</u> and pre- <u>Fuentes</u>

period, debtors' property could be seized without notice and hearing and persons could be jailed in Maine for debt. (Debtors' prison in Maine was outlawed in 1971.) Because of the absence of consumer protection in the debt collection area, finance companies could engage in practices that are now regarded as outrageous but which were, at the time, within the bounds of the law. This is not to say that finance companies did not step over even these lenient proscriptions in collecting their debts from time to time. However, it must be understood that in the late 1960's, when some of debt collection practices and the laws that allowed them (or the absence of law) were increasingly coming under criticism, finance companies received a corresponding amount of rebuke at the same time for using these still "legal" avenues.

Unsatisfactory Enforcement of Existing Law: During this period when alleged abuses were coming into the public limelight, there was little that was done by the principal regulator, the Bank Commissioner. Scattered throughout the Legislative floor debates of the period were oblique, and sometimes pointed, references to the lack of enforcement of existing law (see, e.g., Senator Mills remarks on the Wilco case, Legislative Record, p. 3583, June 12, 1969). There was also some distrust evident in moves by the Banking Commissioner to have bills curbing finance company practices put on the Senate Appropriations Table, in which it was represented additional examination staff would be needed, as ways to kill particular legislation.

Anecdotal information from former members of the Staff of the Division of Personal and Consumer Finance within the Department of Banks and Banking, who are current employees of the Bureau of Consumer Credit Protection, corroborates at least the first of these accusations.

In short, a variety of reasons accounted for the negative image finance companies had in the eyes of many legislators and members of the public. The practice of continuous refinancings, which was but one more, is obviously the most celebrated. Many of these abuses noted have been corrected (<u>see</u>, Section V, subsection A) and would not be affected by any change in the 37-month rule. The 37-month rule should not, therefore, be misunderstood as being the sole preventative device against finance company abuse such that if it is repealed or modified, <u>all</u> the problems of the past will recur.

D. ENACTMENT OF THE 37-MONTH RULE; SUBSEQUENT EFFORTS AT REPEAL

As noted above, the enactment of the 37-month rule was accomplished in 1967, along with the adoption of several other significant small loan law amendments. While there were many outspoken critics of the small loan industry in Maine, it would be erroneous to conclude on the strength of their opposition that they spoke for all interested persons or elected officials. In fact, the key votes on the 37-month rule's adoption (in 1967,) were quite close particularly in the Senate, and even closer in the Senate in 1969 when substantial revision of the Rule (tantamount to repeal) was considered.

For example, during the debate on Passage To Be Enacted of L.D. 986 in 1967, it was moved to place the bill on the Senate Appropriations Table. Senator Mills, a strong proponent of the bill, characterized the move as an underhanded way to kill the 37-month provision. Although Senator Mills failed to keep the L.D. off the Appropriations Table, and the bill was ultimately enacted on July 1, 1967, the vote was a close 17-13.

By 1969, two years after enactment of the 37-Month Rule, but still a year before the 8% "penalty" provision would be triggered, 24 finance company offices had closed. The Business Legislation Committee again faced the 37-Month Rule. The committee reported L.D. 810 (An Act Relative to Contracts of Loans Under Small Loan Agency Law) out with a unanimous Ought to Pass as Amended report. The Committee amendment kept the law as enacted, but changed the 8% penalty rate to 12%, principally because the prime rate had recently risen to 8½% and legislators saw the original rate as far too punitive under such circumstances.

On the floor of the House a far more favorable floor amendment to finance companies was adopted, essentially tracking the original L.D. which the Committee had amended, which avoided the application of the 8% penalty rate if either (a) the loan had been refinanced and paid out in full no later than 6 months after the rescheduled maturity date or (b) at the time of refinancing the customer had made at least 75% of his scheduled payments. The vote to indefinitely postpone this floor amendment on June 10, 1969, was 32 for, 84 against (and 34 absent).

In the Senate, the vote to adopt the House amendment was 17-13 in favor. On a later vote on June 20, 1969 on indefinite postponement of the amended bill, the motion failed because of a tie 15-15 vote.

Later on Passage to be Enacted in the House, on June 25, 1969, another motion to indefinitely postpone was defeated 64-74 (12 absent). The bill was then finally enacted in both houses.

On June 30th, however, Governor Curtis vetoed the bill. His veto was sustained in the House by a 28-89 vote.

It is evident from these votes that the 37-Month Rule upon enactment, and upon later favorable amendment (favorable to the finance companies), was hotly debated. There was not universal sentiment against finance companies by any means. To the contrary, it is clear that many legislators saw the industry as important, and, while acknowledging that violations had occurred, were not about to attribute these to all licensees.

In debating House Amendment A to Committee Amendment A to L.D. 681 (primarily dealing with credit insurance sales by loan companies) in 1967, Mr. Dennett of Kittery stated:

> I'm quite aware of the many injustices that are wrought by some of these small loan companies. I too am a little fearful that if they are pressed too hard there might be results which would not be exactly for the good of the people of the State of Maine as a whole. Now I mean by this that these small loan companies apparently do fill a need; people whose credit is no good at banks and lending institutions of - I might even say a higher caliber, are forced many times to go to these small loan institutions, but there are things that are worse that exist. If these people who are forced to go to money - are forced to go truly to the loan sharks who are not regulated in any manner because they are working underground in most instances, then the people of the State of Maine would suffer more.[6]

Similar sentiments were expressed by Senator Barnes of Aroostook in debating L.D. 810 in 1969.[7] In the House, in later debate on the same bill, Representative Henley from Norway pointed out that constituents of his had lobbied him for easing the 37-Month Rule because it was interfering with their ability to get credit. At least two of the constituents were small businesses (logging and farming) who were "carried by the small loan companies for a good many years" and who had lost access to credit because of the 37-Month Rule.[8]

Even Senator Levine of Kennebec, an outspoken critic of abusive loan company practices and strong supporter of the original 37-Month Rule, stated in June 20, 1969 debate on L.D. 810: "I am not against small loan companies, We need them, there is no question about it...."[9] (Senator Levine's remarks were made in the context of opposing L.D. 810, and keeping the 37-month rule unamended.)

Governor Curtis' remarks perhaps best sum up the Legislative consensus when he stated in his June 30, 1969 veto message:

> I do not wish to suggest that small loan companies do not play an important and legitimate role in the financial affairs of our communities. They are often the only source of credit for people who are badly in need of financial help and who, because of marginal financial status, are cut off from other sources of credit. Most small loan companies deal with these borrowers in a reasonable way. But in return for the risk of providing credit to these marginal borrowers, the state permits the small loan companies to charge a high rate of interest. Indeed, our small loan regulatory laws are, and they remain, favorable to small loan concerns.
>
> The balance between the interest of the small loan companies and the welfare of their clients must be carefully preserved. There is simply no denying the fact that in recent years this balance was seriously disturbed by the conduct of some small loan companies, to the detriment of many poor people who simply did not understand the obligations they were assuming. The present law passed in 1967 was designed to protect the balance between the needs of borrowers and the profits of the small loan concerns. Until we have more experience with the regulations under existing law I do not believe we have a sound basis for nullifying the present law designed to protect consumers.

In short, there was general acceptance that loan companies were necessary to the State (even if acceptance was somewhat grudging on the part of some) and that what was needed was simply better control of their behavior. Bills better regulating interest rates, credit insurance, loan maturities and disclosure were enacted in the 1966-1969 period toward this end. Finance companies argued that the combination of such laws, but particularly the application of the 37-Month Rule, would make operations unprofitable and they would leave the State.

Legislators supporting the 37-Month Rule, and the Governor, saw such threats as bluffs and were willing to call them. When the finance companies started to leave their critics refused to believe their arguments, instead attributing their departure to dissatisfaction at no longer being able to earn obscene profits. (Others attributed their departure as necessary on their part to prevent the spread of the 37- Month Rule to other states - if they remained in Maine, and it could be argued they could live with the 37-Month Rule, it could spread.)

Regardless of the reason or reasons, finance companies left the State, or ceased operations, in dramatic fashion. As noted previously, in 1967 there were 116 licensees. The number of licensees declined as follows: 1968-108; 1969-89; 1970-63; 1971-56; and 1972-20. By 1984 there were no companies making small, stepped-rate loans in Maine.

E. ACADEMIC ANALYSIS OF 37-MONTH RULE

As is the case in our federal system, each state has the latitude to become a separate laboratory of social change, experimenting with different approaches to common problems. Maine happened to be alone in pursuing the tack of limiting loan maturities and prohibiting refinancings as a way to control finance company abuse.

Within a few years of the enactment of the law and the commencement of the experiment, academicians turned some attention toward Maine to test the hypotheses that underlay the legislation and to examine the consequences of the experiment. Professor George J. Benston of the University of Rochester, assisted by Dr. Neil Murphy of the University of Maine undertook such a study and the results appeared in 1974. A companion report dealing with a related issue was also published by Professor Benston in 1976.

Because both articles have already been summarized by Bob Dunn, Research Assistant in the Office of Policy and Legal Analysis, for the Committee in memoranda dated September 15, 1986 and October 21, 1986, (see Appendices 4 and 5) no effort will be made here to restate or analyze Professor Benston's work.

The gist of the articles is, however:

1. Empirical tests of the anti-finance company theories -that abnormal profits were being made, that improvident loans were being made to uncreditworthy borrowers, that finance company indebtedness promoted bankruptcy, and that other lenders filled the void left by finance companies more cheaply and beneficially to consumers - proved them wrong.

2. That the 37-Month Rule has been detrimental to consumers and should be repealed.

A recent review by Bob Dunn of a 1983 Study by the General Accounting Office on consumer bankruptcy (see Appendix 7) corroborates Professor Benston's research that finance company debt is not a principal causal factor in consumer bankruptcy.

In short, academic analyses of the theories that underlay Maine's 37-month rule, and general studies on related issues (bankruptcy) have proven that adoption of the 37-month rule was unwise from an economic theory perspective. While the law eliminated the problem of loan refinancings it did so at the expense of consumer choice, as well as the availability of credit to certain segments of Maine society. Whether that problem has been remedied by subsequent developments in Maine's credit marketplace will be examined in Section II of the Report.

SECTION II

CREDIT AVAILABILITY IN MAINE - THEN AND NOW

As noted in Section I, subsection A, of this Report, in 1967 finance companies had $31 million in loans outstanding to Maine consumers and businesses. By 1972, that amount had dropped to less than $11 million. To determine the impact this reduction was having on consumer borrowing, in 1971 Professor Benston interviewed 460 former "good" customers of four finance companies (which, because of the 37-Month Rule, were not making any new loans).[10]

The interviewees were asked if they were able to obtain replacement funds for those they previously obtained from finance companies. The responses revealed that 50% of the 460 were unable to obtain funds elsewhere. Characteristics such as occupation, salary, age, marital status, number of dependents, percent of loan unpaid at the time, years in debt and previous loans to the finance company did not differ statistically between those who could get funds and those who could not. However, what did differ was the purpose for which the funds were sought. A greater percentage of those who wanted funds for such things as purchasing furniture, or other household items, were unable to get them compared to those who wanted funds for debt consolidation or purchasing a new car. The percentage of each group seeking funds for such things as payment of medical bills, home improvements, and school expenses, were about the same, so there is no evidence to suggest that those persons not receiving funds were unable to obtain funds because their intended use of those funds was less "socially acceptable."[11]

Of those able to obtain funds, approximately 40% shifted to another finance company, approximately 33% obtained funds from banks, 21% from credit unions and the balance from other sources (none reported loan sharks).[12] With the final demise of finance companies the 40% who borrowed from them were now without a source of funds. Based on reports filed with the Bureau of Consumer Credit Protection, for 1985 lending, it is estimated that $2.3 billion in consumer credit was extended in this State last year. This Section of the Report will evaluate the role of other credit sources in Maine and whether the decrease in credit availability noted by Professor Benston has been eliminated by these sources.

A. THE ROLE OF FINANCIAL INSTITUTIONS

1. Types of Financial Institutions:

In Maine, at present, there are four types of financial institutions: commercial banks (sometimes called Trust Companies), savings banks (sometimes called "Thrifts"), savings and loan associations and credit unions. (Credit Unions will be addressed in more detail in subsection B, infra.) Each of these institutions can be either state or federally chartered. The choice of charter is significant for it determines much of the law an institution will be subject to as well as the principal regulator. While state chartered banks are principally subject to the Maine Bureau of Banking, they are also subject to the federal insuring agencies such as the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation, and their holding companies are also subject to supervision by the Federal Reserve. Regardless of charter or regulator, each type of institution behaves basically the same and serves basically the same market.

Exhibit 1

FINANCIAL INSTITUTIONS IN MAINE
as of 12/31/85

	Companies	Branches
1. Commercial Banks Trust Cos	17	204
2. National Banks	8	110
3. Thrift Institutions Savings Banks	19	118
4. Federal Savings Banks	5	10
5. State Savings & Loans	4	0
6. Federal Savings & Loans	7	13
7. State Credit Unions	18	3
8. Federal Credit Unions	118	5

SOURCE: State of Maine, Bureau of Banking

Historically, the roles of the various financial institutions were quite different. In the mid-sixties, commercial banks' virtual sole contact with consumers was by way of automobile loans. Their principal focus was on commerical lending and trust management. Savings and Loans made home mortgage loans almost exclusively. Savings Banks made mortgage loans as well, and a small number of personal loans secured by passbooks. Credit Unions were the principal financial institution source of personal loans. Credit Unions numbered about as many as today, but because the "common bond" theory of Credit Union membership was narrower than it is today, fewer consumers were members. The now-familiar credit cards - VISA and MasterCard (formerly BankAmerica card and MasterCharge, respectively) - were just in their infancy. Thus, the principal source of consumer lending was the finance company.

2. Lending Practices of Financial Institutions

Over the last decade or so, the distinctions between types of institutions has blurred considerably. The real push came in the early 1980's with major banking deregulation. The most notable change involved thrift institutions that received commercial lending authority, thus enabling them to compete head on with commercial banks. Since that time thrifts and commercial banks have offered a full range of financial services to more customers, including first mortgages, home equity lines and credit cards. These institutions have also aggressively sought out dealers for consumer installment contracts. Credit unions have also expanded with the acceptance of share draft accounts, credit cards and even first mortgage lending.

For example, as the figures from Exhibit 2 illustrate, state chartered financial institutions provided $512.9 million of direct, non-real estate secured consumer lending in Maine in 1985. If second mortgages are included,

Exhibit 2

STATE CHARTERED FINANCIAL INSTITUTIONS

1985 YEAR-END FIGURES

		1985	1984
State S&L's	Installment Loans	$ 653,560	$ 861,239
	Time & Demand Loans	700,589	1,095,026
	Second Mortgage Loans	652,503	801,973
	Total Consumer Volume	$ 2,006,652	$ 2,758,238
State Credit Unions	Installment Loans	$ 54,799,201	$ 52,917,531
	Open-End Loans	5,044,065	4,914,111
	Time & Demand Loans	278,467	44,104
	Second Mortgage Loans	1,189,667	635,227
	Total Consumer Volume	$ 61,311,400	$ 58,510,973
State Savings Banks	Installment Loans	$102,224,720	$ 73,301,912
	Open-End Loans	$ 35,471,644	$ 10,510,915
	Time & Demand Loans	$ 36,058,111	$ 20,381,403
	Second Mortgage Loans	$ 15,318,101	$ 12,505,951
	Subtotal: Direct Consumer Volume	$189,072,576	$116,400,181
	Assignor Sales	18,020,656	469,488
	Total Consumer Volume	$207,093,232	$116,869,669
State Trust Companies	Installment Loans	$135,960,459	$146,993,767
	Open-End Loans	112,172,261	80,165,248
	Time & Demand Loans	29,617,716	27,849,006
	Second Mortgage Loans	13,390,992	3,773,852
	Subtotal: Direct Consumer Volume	$291,141,428	$258,781,873
	Assignor Sales	80,769,208	72,901,566
	Total Consumer Volume	$371,910,636	$331,683,439
	Totals Less Assignor Volume	$543.5 million	$436.5 million
	Assignor Volume	98.9	73.4
		$642.4 million	$509.9 million
	Totals Federal Credit Unions	$320.8 million	$325.9 million

SOURCE: BUREAU OF CONSUMER CREDIT PROTECTION that figure jumps to $543.5 million. (Interestingly, the 118 federal credit unions were the largest provider of consumer credit by far, providing $320.8 million.) When assigned dealer paper is included, the state-chartered financial institutions, and the federal credit unions, provided just under $1 billion of consumer credit in Maine in 1985. (Figures are unavailable from federally chartered commercial banks, S&Ls and thrifts who are not required to report to the State.) While the figure appears huge, it represents only $871.67 per capita.

A further review of the figures illustrates the growth into the consumer credit market made by savings banks. In 1984 savings banks lent $116.8 million of the $509.9 million extended, or 23%. Commercial banks lent $331.6 million or 65%. In 1985, commercial banks' $371.9 million lent represented 60% of the total advanced by state chartered financial institutions, while savings banks share increased to $207 million or 32%.

Notwithstanding the above, a recent survey (Feb., 1986) by the Bureau of Consumer Credit Protection of minimum loan requirements of commercial banks, savings banks and S&Ls revealed an average minimum loan size of $860. (See Appendix 8 for the complete list.) The range ran from two institutions that imposed no minimum to two that would make no closed-end loans under $2,500. Analyzed by type of institution, commercial banks averaged at $744; savings and loans at $800; and savings banks $957. It is interesting to note that savings banks, which appear to be making aggressive strides in the consumer lending area are the least willing to make small loans. To the extent other bank lenders may be supplanted by savings banks, minimum loan sizes are likely to rise to all consumers.

The response of most institutions to consumers seeking small amounts of credit is to have them apply for a credit card. Open-end credit is desirable for lenders because of the minimal costs associated with maintenance of the account once opened, and the ability to supply future credit to the customer at very low cost (no further credit checks, no new disclosures). However, it is precisely because open-end credit can be accessed 6 months or a year later by the consumer, whose financial condition may well have changed, that banks only grant such credit to consumers who have stronger credit characteristics. In short, the marginal customer, seeking a small amount of money, won't get a credit card and won't get a loan.

Interestingly, one of the reasons cited by a number of bank lenders as to why their minimum loan sizes are so high is that the 18% rate ceiling does not allow them enough earnings to justify the costs of underwriting the loan. While the stepped rate loan provision of §2-401, of up to 30% on loans of less than $700, is available to banks, they purposely choose not to use it <u>because of the 37-Month Rule</u>. Because of the breadth of §2-308(3), a bank could risk having all of its loans with a customer - a car loan, a mortgage, a credit card - drop to 8% if the one, above -18%, loan does not pay out within 37 months of inception. Thus, by operation of a provision designed to cure the ills of finance companies the 37-Month Rule has also dissuaded virtually all banks from making high-rate, small loans to their customers.

3. <u>Access to Credit: Impact of Consolidations and Mergers</u>

Banking remained a relatively staid industry until recent times. The prohibitions against interstate banking, and even the prohibition against <u>intrastate</u> expansion, produced thousands of single branch, independent banks. While large credit needs might not be capable of being served by small town banks, presumably local needs could. To the extent that relaxation in geographical restrictions in intrastate banking has occurred, mergers and consolidations have resulted in decreasing the number of institutions, if not the number of branch locations. While economies of scale have certainly resulted in lowered administrative costs, which have been a boon to borrowers, and larger institutions have access to bigger credit markets, to the extent local lending decision making gets removed from the local area, or lending policies become bureaucratized such that local flexibility is gone, mergers and consolidations can be detrimental.

Maine has witnessed significant change in this area as Exhibit 3 illustrates. While the number of branches has increased, the absolute number of independent banking organizations has declined significantly. Since 1970, 70 have gone out of existence, a 23% declined. While there is no conclusive evidence that consumers are less well served, testimony by an Aroostook County car dealer at the public hearing on L.D. 2043 (March 4, 1986) indicated the car loans for customers were harder to get. Comments by a number of the Business and Commerce Committee from the area corroborated the car dealer's claims.

When taken in conjunction with the minimum loan size standards described above that statewide banking organizations now impose, which do not allow much flexibility in their application, the car dealer's observation about credit unavailability gains further intuitive support.

Exhibit 3

NUMBER OF INSTITUTIONS AND BRANCHES BY TYPE
DECEMBER 31, 1985

BANKS - BRANCHES

	1950	1970	1980	1985
Commercial Banks	30-62	20-124	27-191	17-204
National Banks	32-8	19-103	14-102	8-110
Savings Banks	32-1	32-24	29-102	19-118
Federal Savings Banks				5-10
State Savings & Loans	30-0	18-2	12-20	4-0
Federal Savings & Loans	5-0	9-3	8-5	7-13
State Credit Unions	8-2	29-2	25-4	18-3
Federal Credit Unions	42-0	171-2	139-2	118-5
Industrial Banks	2-1	8-6	0-0	0-0

SOURCE: "The Status of Maine's Financial Institutions," Maine Bureau of Banking, January, 1986

4. Impact of Interstate Banking

Maine was the first state in the nation to allow interstate banking, permitting it as early as 1978. Because of the reciprocity requirement (i.e., that the state from which the acquiring bank came had to have a law allowing Maine banks to acquire banks in that state), no mergers occurred. In 1982 the reciprocity provision was eliminated and a "net new funds" requirement became the only condition to interstate acquisition of Maine banks. It was assumed that Maine being a capital-poor state would gain access to larger capital markets via interstate mergers, and as long as funds could not be syphoned from Maine, there would be benefit. The "net new funds" provision (9-B M.R.S.A. §1013(4)) required acquiring banks to specify in the merger applications how those funds would be applied to serve the credit needs of individuals and small businesses.

The first interstate merger did not occur until 1983 with the acquisition of Northeast Bankshare Association of Portland by Norstar Bancorp, Inc. of Albany, New York. Although banks of any size are permitted to affiliate across state lines, so far it has been the larger banks in each state that have tended to consolidate with each other. The one exception in Maine in the seven subsequent transactions that have occurred since 1983, was the acquisition of Oxford Bank and Trust of Oxford, Maine, by BankVermont Corporation of Burlington, Vermont. This acquisition created the first interstate bank holding company located entirely within northern New England. BankVermont, with $550 million in assets is the smallest bank to acquire a Maine bank and Oxford with approximately $32 million in assets is the first small Maine bank to be acquired. At present, the five largest Maine banks, and 88% of all deposits, are controlled by out-of-state banks.[13]

Have the mergers and "net new funds" requirement been helpful to Maine consumers and businesses? The answer is less than clear. Observers of the interstate banking issue have doubts. Constance Dunham in the New England Economic Review[14] (the house organ of the Federal Reserve Bank of Boston), expressed concern by saying that most savers should benefit from the higher interest rates typically offered by affiliated banks but that other individuals and very small businesses, no longer the focus of these banks, may be hurt, especially if local thrifts or other financial institutions are slow in providing them with alternative banking services. The article notes that while virtually all of the loans of small banks are made locally, less than 40% of loans of large banks, are local. Although small banks tend to lend less of their total funds than large banks, they tend to lend more of their total funds to local customers than large banks do. (Historically, the larger banks dealt with the manufacturing sector, while the smaller, locally-owned banks dealt with the farming, fishing and agricultural segments of the economy. This was due in large part to the geographic distribution and community orientation.)

The target area of these larger out-of-state banks seems to be what are referred to as middle-market firms. These are non-financial firms with annual sales of $10 million to $150 million. The Maine Merchants Association has over 2,000 members on its rolls and the Bureau of Banking reports that 91% of Maine businesses employ fewer than 20 persons. The vast majority of these firms are not middle-market firms. Hence they are unlikely to be the sought-after customers of these larger financial institutions.

Will the "net new funds" requirement help these small businesses and consumers? Recent experience seems doubtful. Section 1013, subsection 3(B), requires an acquiring bank to maintain "minimum equity capital" in an amount the Banking Superintendent determines to be acceptable given the market area to be served and general plan of business of the bank being acquired. In no case, however, shall the equity base be less the $3 million in the case of a de novo bank or $1 million is the case of an acquisition.

Although many banks have contributed more than this minimum, how they have spent it leaves doubt as to how small business and consumers are being served. For example the Bureau of Banking reports that two New York affiliates of Norstar are providing $17 million of the $21 million needed to finance the One City Center project in Portland. While it is true that this represents a substantial expenditure of funds in the economy of the area, how much "trickle down" effect will there be to a small business 50 miles away? In another example, Bank of Boston has invested $6.6 million in net new funds and has relocated its payroll services department to Saco at a cost of $750,000. Currently it employs 59 full-time people.

The focus on consumer needs appears to be entirely ignored, and net new funds of many large interstate banks seem to be being provided by investment in bricks and mortar for their own benefit.

In summation, it is unclear just how much banking establishments have picked up consumer credit needs since the departure of the finance companies. While there certainly appears to be healthy growth in consumer lending, minimum loan sizes are still high. Further, through the process of mergers and consolidations there are now fewer players with arguably more profitable orientations than local consumer lending.

B. THE ROLE OF CREDIT UNIONS

1. Historical Growth

The first credit union chartered in the State of Maine was the Telephone Workers Credit Union in 1921. Early credit unions were all chartered by the Legislature and were formed as thrift institutions to encourage savings by their members.

Since those early days credit unions have enjoyed a rapid growth in the State and continue to do so. In fact, they continue to grow more rapidly than other financial institutions.[15] As of December, 1985, there were 123 federally chartered and 21 (including branches) state chartered Credit Unions operating in Maine. Collectively, they have 394,466 members or about 35% of the population of the State.

The major growth period for credit unions occurred between the years 1950 and 1968. The number of Federal Credit Unions more than doubled from 42 to 89 in the six year period from 1950 to 1956. From 1956 to 1962 there was a further increase from 89 to 117 or 31%. During this same six year period there was a dramatic growth in State chartered credit unions: 9 institutions with 2 branches in 1956 to 25 institutions with 2 branches in 1962. During the final six-year period from 1962 to 1968, 48 more federal credit unions were chartered, as were 4 state chartered credit unions.

While it is often assumed that there was a causal link between the decline of finance companies and the growth of credit unions, it is apparent from these statistics that much of the growth in credit unions occurred well before enactment of the 37-Month Rule. In fact, 1970, the first year in which the 37-Month Rule truly took effect, credit unions were at their peak in terms of number: 171 federal and 29 state. Since then numbers have declined fairly significantly to 118 federal (a 31% decline) and 18 state (a 38% decline).

As noted above, despite the decline in number of institutions, credit unions have grown, and continue to grow, rapidly in terms of deposits and loans. In 1970 federal credit unions had $78.3 million in deposits and made $77.8 million in loans. In 1985, deposits had ballooned nearly ninefold to $696.4 million, while loans had grown to $476.2 million. The situation with state chartered institutions is not as dramatic as the federal experience, but it is still impressive. In 1970, state chartered credit unions had deposits of $25.8 million which have risen more than five times to $133 million. Loan volume has grown as well, but only tripling, from $22.8 million in 1970 to $84.5 million in 1985. (See Appendix 9 for actual statistical breakdowns.)

Deregulation has played an important part in this growth as it has allowed credit unions to expand their services into the more traditional areas of banking. Of particular note are the share draft program, which is basically a checking account, credit cards, business loans, and variable rates on mortgage loans. Also because of such lower overhead factors as volunteer labor, free or nominal rent in many cases and exemption from the payment of certain taxes required of other financial institutions, credit unions are generally able to pay higher interest on deposits and charge less for services than traditional financial institutions.

2. Membership and Borrowing Criteria

Credit Unions are composed of three types:

(1) Occupational (most common) - comprised of employees of a particular

company, such as Health-Tex Employees Federal Credit Union, or members of a particular occupation, such as fishing (e.g., Fisherman's Credit Union).

(2) Associational - comprised of members of an organization. An example would be K of C #106 Credit Union.

(3) Community (least common but seems to be gaining at the expense of #2) - usually comprised of members who live within a certain geographic boundary. An example would be St. Pierre Credit Union in Lewiston which was formerly associational and is now community, now known as Community Credit Union. The primary reason for the change from associational to community is to broaden the membership base which in turn allows the credit union to offer a wider range of services to its membership as a result of certain economies of scale.

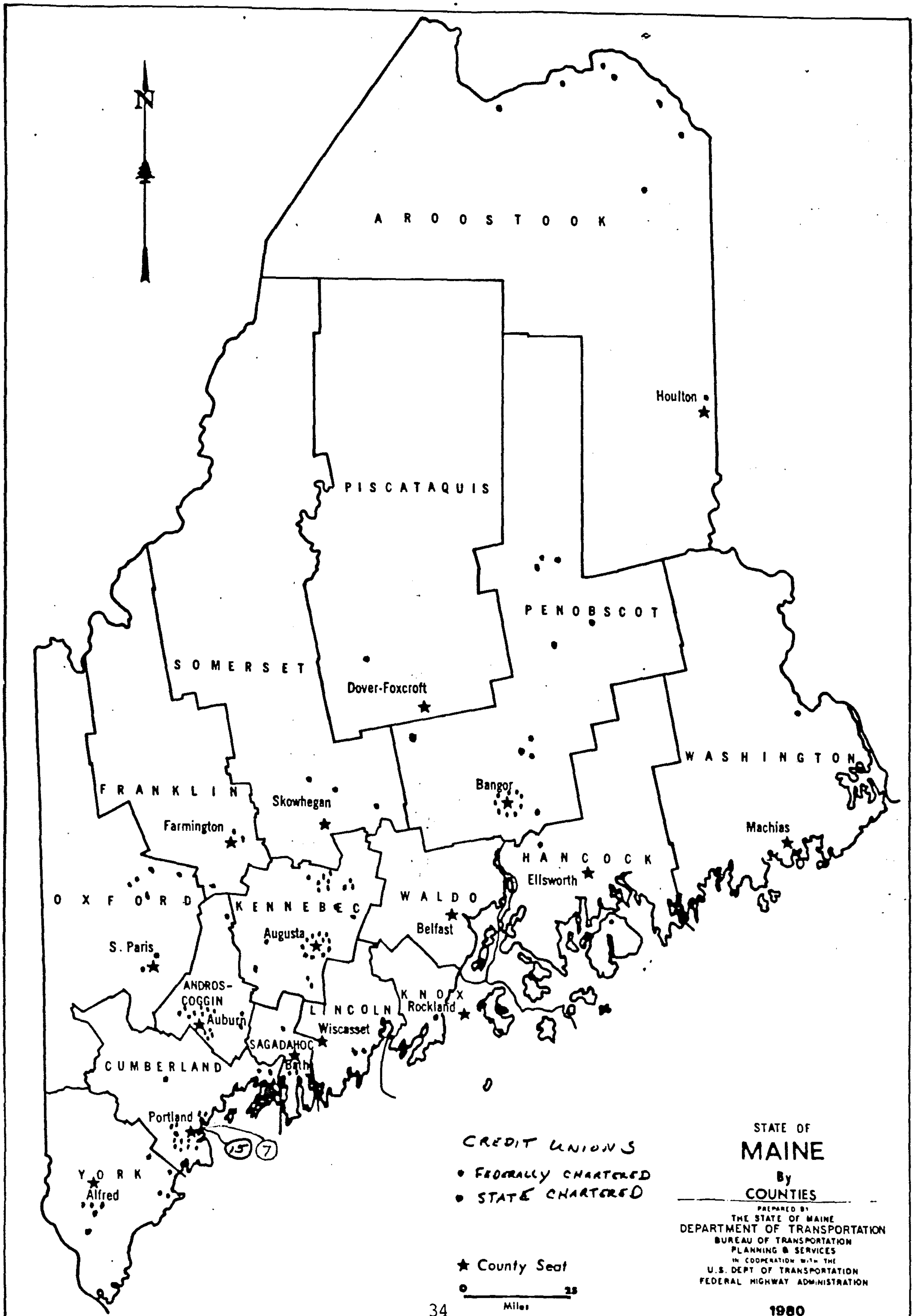
While lending policies vary from credit union to credit union, depending upon the criteria the Boards of Directors establish, it is not uncommon for minimum membership or employment periods to transpire before a member can borrow. Oftentimes, as well, unsecured loan lending limits are tied to length of employment or length of membership. Thus, while rates may be lower than competitors' for the reasons identified above, certain other characteristics of credit union operation may impair their ability to supply the credit needs of even their members.

Moreover, as noted above, the number of credit unions has continued to decline over the last 15 years. While this trend has been correctly identified as not indicating a weakening in credit unions (to the contrary, they are growing), what it does indicate is perhaps a lessening accessability to credit unions. As noted on the following map, credit unions appear to be concentrated in the major population areas of the state, thus providing little or no service to consumers in rural areas.

In conclusion, while credit union growth has been impressive, still only 35% of the population of the State are members. Without firm information on the overall demand for credit statewide, it is impossible to say if credit unions are filling the void created by the departure of finance companies. Judging solely on the percentage of membership and physical locations, one would have to assume they are not. Moreover, because of by-law restrictions in some credit unions that may limit loan size, or when one can borrow, there may even be situations in which credit unions are incapable of meeting their own members' needs for credit.

Credit unions were never intended to be the sole source of consumer credit in a community. The experience of other states, discussed in Section III, infra, indicates that credit unions and finance companies can and do coexist.

(See Appendix 10 for location of existing credit unions.)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Machias
HANCOCK
Ellsworth
OXFORD
KENNEBEC
WALDO
Augusta
Belfast
S. Paris
ANDROS-COGGIN
KNOX
Rockland
Auburn
LINCOLN
Wiscasset
SAGADAHOC
Bath
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DEPARTMENT OF TRANSPORTATION
BUREAU OF TRANSPORTATION
PLANNING & SERVICES
IN COOPERATION WITH THE
U.S. DEPT OF TRANSPORTATION
FEDERAL HIGHWAY ADMINISTRATION
1980

C. SALES FINANCE COMPANIES

Sales Finance Companies although small in number are playing an increasingly important role in consumer financing in Maine. Based on figures reported to the Bureau of Consumer Credit Protection, as of year-end 1985, sales finance volume of the 22 sales finance companies doing business in Maine rose to $300 million from $170 million in the previous year. An additional $40 million in assigned consumer leases (up from only $6.6 million the year before) brought the total sales finance volume to $340 million.

Sales finance companies are non-bank, indirect providers of consumer credit. Credit is provided by the sales finance company buying an installment sale contract (taking an assignment) from a retail merchant to whom the obligation is initially payable. The sales finance company makes its money, in part, by buying the contract at a discount. While the dealer assigning the contract does not earn full face value for it, he does receive his money upon assignment which he can then use to pay his creditors or reinvest in more inventory.

Because of the demise of the holder-in-due-course doctrine in consumer credit transactions (see, §3-403) an assignee is subject to all claims and defenses a consumer may have against the assignor (the original creditor). Thus, if there is a breach of warranty and the consumer stops paying on the contract, the consumer can raise that defense against the assignee if the assignee sues the consumer for breach of the installment contract. Further, under §8-209, assignees are also subject to penalties for truth-in-lending violations that are apparent on the face of the contract. Because of this potential liability, sales finance companies usually have rigid internal quality control, screening contracts from dealers carefully before buying them. Generally, if a contract contains a TIL violation, it will not be purchased.

The three automobile financing giants - GMAC, Ford Motor Credit and Chrysler Credit accounted for $296 million or 87% of the $340 million total reported as of year-end 1985. Compared to 1984 figures of $156 million, this volume represents a 90% increase in financing by these companies. (It should be noted that there was not a 90% increase in automobile sales during this period. Some of this growth was at the expense of banks and other sales finance companies that lost dealer business to The Big Three. Growth in volume can also be attributed to inflation in the price of vehicles.)

The other 19 sales finance companies handled the remaining $44 million in sales finance volume. Five of these companies also handled automobile sales finance, bringing the total of all automobile sales finance to $317.1 million, or 93% of total volume.

The remaining volume $23.6 million can be attributed to assignments of furniture and white goods contracts. Compared to 1984's volume, 1985's figure represents a 69% increase. Again, it must be noted that this increase cannot be considered an absolute increase because some of it may have come at the expense of banks which lost business. Further, the Bureau was aggressively pursuing companies that should have filed but had not in years past. Part of this volume thus represents business that had previously been unreported. Finally, the impact of inflation would cause figures to rise from one year to the next.

The three biggest sales finance organizations beside the captive auto finance companies were General Electric Credit Corp. (GECC), Citicorp Acceptance Co., Inc., and Whirlpool Acceptance Corp. These three accounted for $28.2 million or 8% of the total. All of Citicorp's business involved automobile sales finance.

From the standpoint of credit availability, the extent of GECC's and Whirlpool's dealer networks provides some insight into credit access even in more remote areas of the State. GECC has nearly 200 dealers across the State, 94% of which are south of Bangor. Whirlpool, on the other hand, with 122 dealers, has 23% of its dealers north of Bangor. Because 22 dealers currently participate in both networks, there is a net figure of 297 individual businesses in Maine served by these two companies. Collectively, they assigned $19.5 million in sales to GECC and Whirlpool for everything from toasters to furniture to stoves to snowthrowers.

As noted above, there are an estimated 7,000 retail merchants in the State, 460, or 7%, of which extend credit directly or indirectly. There is no question but that sales finance companies, by buying dealer paper, have made it possible for many consumers, particularly in rural areas, to purchase household goods. However, judging from the fact that a majority of small merchants surveyed by the Bureau (see Section IV, subsection H, infra) would welcome the return of finance companies, one can conclude that there is still an unmet demand for sales finance consumer credit in Maine.

D. INTERNAL FINANCING

Credit under Maine law exists when an obligation can be repaid in more than four installments (excluding the downpayment) or when a finance charge is imposed for the privilege of paying the obligation later than at the time of sale.

There are an estimated 7,000 retail merchants in the State of Maine. Based on reports filed with the Bureau of Consumer Credit Protection, only 460, or 7%, offer any kind of credit, as defined above, for their customers. (There are an additional 357 branches of these 460 businesses, bringing the total number of actual facilities to 817.) Of these 460, most, assign their contracts to sales finance companies or banks. Thus, the actual number of businesses that carry their own accounts is limited to less than 100.

The vast majority of retail establishments in Maine offer no financing options to their customer, or at best, offer "non-installment" credit. Non-installment credit would include 30-day-type accounts, such as one might find at hardware stores, lumber yards, oil dealers, etc., where the full amount of the purchase had to be paid within a certain number of days. Based on 1984 estimates of the Federal Reserve Board, there was $119 billion worth of such credit in the United States. With Maine's population of 1.1 million, Maine's proportionate share of this is an estimated $545.4 million.

In the same vein, the acceptance of a credit card such as VISA, MasterCard, American Express, Discover, etc., by a merchant is not the granting of credit by that merchant. (The credit being granted in such case is granted by the card issuer to the cardholder.)

Based on reports filed with the Bureau for 1985, there was $208 million of internal credit in Maine. Considering that the five biggest creditors in this category - Sears, Jordan Marsh, Porteous, J. C. Penney and Frank X. Pomerleau's accounted for $128.6 million, or 62%, it is seen that the remainder is spread among a large number, making their individual credit extensions very small. In light of the fact that internal credit offered by merchants in Maine comprised only 9% of all credit extended, and further that such credit is in the form of sales finance (not loans of cash), its role in meeting the overall needs of Maine consumers is limited.

E. CREDIT CARDS AND ATTITUDES ABOUT DEBT

1. In-State Developments:

In the approximately 20 years since the passage of the 37-month rule, there appears to have been a marked shift in societal attitudes toward debt. According to the Federal Reserve Board, total consumer installment debt in the first quarter of 1986 was at a record $530 billion, up 20% from a year earlier. While older Americans still revile the notion of debt, younger generations see it as an acceptable aspect of modern life, enabling them to obtain the things they want today, without having to save and wait. Until the new Tax Code revision, the federal government and this State, encouraged the notion by allowing all interest payments on Consumer debt to be fully tax deductible.

What has facilitated this growth in consumer debt perhaps more than any other development in the last two decades has been the use of open-end credit, through the mechanism of the credit card. As of 1984: 39.4 million households in the U.S. (43% of all housholds) had a VISA card; 33.5 million households (37%) had a MasterCard and 20.7 million households (23%) had both cards, 38% carried a revolving balance. The median balance was $640. Twenty percent of all households with credit cards said they paid only the minimum amount due each month.[16] When all credit cards are added in, such as department stores and gasoline cards, there are an estimated 703 million cards outstanding.[17]

Relating these figures to Maine, according to the State Planning Office, there were just under 400,000 households in Maine according to the 1980 Census. Applying national statistics to Maine, 172,000 households have VISA cards, 148,000 have MasterCards and 92,000 have both. According to these estimates, then, there must be 228,000 households in Maine with at least a VISA or MasterCard (172,000 + 148,000) - 92,000 = 228,000). Applying the national statistics to this figure, 38% or 86,640 households maintain a balance on their account from month to month (38% of 228,000) and 20%, or 45,600, households make only the minimum payment necessary each month (20% of 228,000). Again, it should be noted that these figures do not include private label cards held by Maine households.

One of the most frequently articulated objections to finance company operation in Maine was the "debt treadmill" nature of their business - continually refinancing contracts and keeping consumers constantly in debt. If that remains a public policy of this State, it appears to be being ignored as the credit card statistics noted above demonstrate.

Further, new products by well respected businesses in Maine appear to fly in the face of this policy. One large savings bank now offers a home equity credit line in which <u>no repayment of principal is required</u> - one pays only interest on the amount outstanding. After five years the line is reevaluated: it can be renewed, expanded, paid off or put on an amortizing basis. If such a product existed in 1967, in which one was pledging one's home as security, it appears certain it would have been subject to rebuke.

2. Out-of-State Developments:

In the last eight years, since the United States Supreme Court's decision in Marquette National Bank v. First of Omaha Service Corp. in 1978, there has been an explosion in the growth of credit cards offered on an interstate basis. The Marquette decision gave national banks the green light to market their VISAs and MasterCards on an interstate basis. The decision interpreted §85 of the National Bank Act to permit national banks to "export" the rate of interst allowed in the State where the bank was located to their borrowers in other States, even if such rate of interest was above what was legal in those borrowers' States.

Thereupon started a bidding war among several states to lure (or retain) large banks by enacting laws favorable to banks that could be exported. The two most successful suitors were South Dakota and Delaware, both of which have deregulated interest rates (allowing banks to charge whatever they want) as well as changed or eliminated several other consumer protections to make the overall law more favorable to banks.

The Marquette decision discussed only the exportation of interest rates. However, by linking that decision with judicial interpretations of federal law extending back more than 100 years, national banks have used Marquette as a springboard for asserting that they can export the substantive contract law of the State where they are located to their borrowers wherever they reside, and that the other consumer protections of those states' law are effectively preempted. In short, a bank such as Citibank is effectively saying that South Dakota law controls its entire relationship with a Maine consumer and the Maine Consumer Credit Code is meaningless.

This kind of behavior is not limited to VISA and MasterCard. A number of merchants are teaming up with national banks to have those banks issue private label cards for the merchant and thereby circumvent State usury laws. The banks are more than willing participants because they get fees as well as new customers to whom they can offer new services. Merchants like the arrangement, for all the headaches of running a credit operation are now handled by the bank. Consumers now pay up to 24% for what had been theirs at 18%.

There is huge money to be made in credit cards in and of themselves, but also because of the customer lists mentioned above. Control of cards is highly concentrated. The ten largest banks have 50% of the entire outstanding credit card debt. The top 25 banks have 60%, and the top 100 control 75%.[18] The interest rates charged by these large banks on their credit cards are consistently among the highest charged by all banks. It is thus easily seen how enormous the stakes are in the continued ability of national banks to run their credit card operations unimpeded by local law.

The Bureau of Consumer Credit Protection is challenging the ability of these banks to export anything but the interest rate of their State of origin. Negotiations are underway with nearly two dozen institutions at the present time, and while some institutions have agreed to abide by Maine law there is no guarantee as to the outcome of other discussions.

While it is clearly not the least creditworthy Maine consumers who are being solicited for credit cards by these out-of-state banks, to the extent any Maine consumer accepts one of these cards jurisdiction over and regulation of that transaction has largely left state control. There will continue to be great effort to obtain Maine consumers as cardholders until the underlying legal issues are settled (and certainly after that if the State is unsuccessful). The extent some of the credit being sought by or accepted from out-of-State banks by Maine consumers is due to the lack of other credit sources in Maine is undeterminable. However, it seems likely that to the extent fairly priced credit is more available in Maine, it will lessen the demand for out-of-State credit, over which Maine's control may be little or nil.

SECTION III

EXPERIENCE OF OTHER STATES

As part of its preparation of this Report the Bureau sent out questionnaires to all 49 other states requesting information on their regulation of finance companies. (See Appendix 11 for a copy of the questionnaire.) The questionnaire sought information on four distinct aspects of finance company activity in each state: loan volume of finance companies compared to loan volume of credit unions and banks; administration and regulation of finance companies; violations and consumer complaints; and trends in lending practices.

Forty-two states responded, although one of those responses, from the State of Arkansas, has no comparative information for there are no finance companies doing business there because of the low usury limit. The seven states not responding were California, Delaware, Georgia, Rhode Island, South Dakota, Texas and West Virginia.

A. LOAN VOLUMES

In most (if not all) states responding to the survey, regulatory authority over loan companies, on the one hand, and banks and credit unions, on the other, is divided. Consequently, many of the loan company regulatory agencies had no statistics on number of credit unions in their states or the dollar volume of credit extended, and did not try to obtain it. Twenty-eight states did provide information, however, which is set forth in Exhibit 4 , below.

Without a full understanding of all of the lending laws in these states, including such things as rate limits, loan maturities, and role of banks (including "industrial banks"),it is impossible to draw any firm conclusions

Exhibit 4

COMPARISON OF LOAN VOLUMES OF FINANCE COMPANIES
vs. CREDIT UNIONS BY RANK ORDER OF POPULATION

STATE	POP.	#F.C.	$ LOANS	#C.U.	$ LOANS
VT	.5m	2	2.7m	66	113.4m
ND	.6m	16	19.3m	65	184.3m
NH	.9m	125	32.8m	31(s)	56.7m
ID	1.0m	122	264.1m	70	92.1m
NM	1.5m	103	262.7m	36	142.0m
UT	1.6m	91	135.8m*	244(s)	706.3m
KS	2.5m	259	335.7m	209	722.5m
OR	2.6m	157	225.4m	170	
IA	2.9m	335	408.6m	300	668.9m
CT	3.1m	61	80.8m	124(s)	295.5m
SC	3.3m	765	1,090.3m	43(s)	167.1m
MS	3.5m	551	656.0m	56	88.7m
CO	3.5m	299		274	
KY	3.6m	286	307.3m	90	198.7m
MN	4.0m	170	510.0m	218	
LA	4.0m	1,180		450	
TN	4.3m	477	458.9m	266	799.4m
WA	4.3m	178	64.2m		1,301.4m
WI	4.7m	248	367.1m	800	1,426.1m
MO	4.9m	272	224.0m	270(s)	1,141.0m
IN	5.5m	801	732.0m	102	351.0m
VA	5.6m	390	364.6m	118	
MA	5.8m	128	118.1m	272	1,167.0m
NJ	7.6m	205	238.8m	41	56.7m
MI	9.0m	69	89.0m	470	1,794.0m
OH	10.9m	675	534.5m	535	1,461.0m*
IL	11.0m	500	442.0m		1,633.0m
NY	17.5m	272	730.9m	73(s)	501.7m

*1984 figures

from the information in Exhibit 4 . The level of analysis is thus best limited to several observations. They include:

1. Credit Unions and Finance Companies are not mutually exclusive and appear capable of coexisting in each of these states.

2. In a State like Wisconsin (which has credit laws similar to Maine's and has historically had a strong consumer protection presence) credit

unions and finance companies appear to be thriving. There are 248 finance companies, lending $367.1 million, and 800 credit unions lending an enormous $1.4 billion.

3. Ohio also appears capable of supporting a strong presence of finance companies (675) and credit unions (535).

4. In Michigan, where finance companies have declined by approximately 80% in six years due to restrictive small loan rate legislation, credit unions appear to have picked up some of the slack. In 1985 they reportedly lent $1.79 billion, the highest amount lent by credit unions in any of the 28 states responding.

Comparisons based on per capita borrowing at financial companies and credit unions in other states reveals that credit unions in Maine appear to be doing a reasonable job in supplying credit to Maine consumers. (Exhibit 5.) Comparisons based on this Exhibit have to be made with extreme caution in terms of relative ranking because it is not clear from the responses if (1) the credit union loan figures includes figures from both state <u>and</u> federal credit unions; (2) the loan company statistics provided by some states may not include second mortgage loans made by other lenders (such loans made by credit unions are included in the Maine statistics); and (3) there may be other types of non-bank licensed lenders making loans in the reporting states that were not included in the statistics supplied.

Notwithstanding those caveats, it is seen that Maine ranked sixth among 23 states responding in terms of per capita lending by credit unions and finance companies.

Exhibit 5

VOLUME OF CONSUMER CREDIT EXTENDED BY FINANCE COMPANIES AND CREDIT UNIONS, 1985, IN RANK ORDER

STATE	$ VOLUME/CAPITA
UT	$526.3
IA	414.4
WA	381.5
SC	380.9
ID	356.2
ME	347.0
ND	339.0
WA	317.6
TN	292.6
MO	278.6

All other things being equal, one might conclude the Maine consumers are not badly off in the absence of finance companies. Again, however, it must be noted that these figures also do not include the role of conventional bank and sales finance lending in each of the states compared. Such information is a prerequisite to any firm conclusion on this subject but it is not available.

B. ADMINISTRATION & REGULATION

The 41 states responding indicated that there were 12,609 licensed loan offices within their states. They also indicated that in 1985 11,728 examinations were conducted of these licensees. (It should be noted that in the case of some of these offices, jurisdiction extends beyond loan companies. Consequently, some of the reported examinations were of entities not included in this Report. To some extent, then, the number of examinations of finance companies is overstated. Likewise, in some cases number of examination staff is "overstated" because the staff examines more than just finance companies.)

Exhibit 6 shows the number of licensees and examinations by state. Virtually all examinations were field exams.

Twenty-five states reported having administrative authority to suspend or revoke licenses. (See Appendix 12 for details.)

Of the 39 states responding to the question on formal administrative action against finance companies, 22 states reported taking no formal action.

Of the 17 states reporting haven taken action the breakdown was as follows:

LICENSE REVOCATION		LICENSE SUSPENSION		OTHER ADMIN. ACTION	
Ohio	5	TN	3	KS	4
KY	3	AL	1 (2 PENDING)	ID	2
SC	3	FL	1	MD	1
IL	2			OR	1
MI	1			WI	1
MN	1				
MO	1				
UT	1				
WY	1				
TOTALS	18		5 (2 PENDING)		9

Exhibit 6

EXAMINATIONS OF FINANCE COMPANIES BY STATE, 1985

STATE	# F.C.	# EXAMS	STAFF SIZE
AL	709	587	
AK	3	3	1
AZ	420	210	
CO	299	325	3
CT	61	63	
FL	672	672	
HA	143	27	17
ID	122	100	2
IL	500	1,176	
IN	801	801	26
IA	335	300	3
KS	259	259	
KY	286	286	
LA	1,180	900	
MD	225	214	
MA	128		
MI	69	64	
MN	170	105	4
MS	551	527	
MO	272	210	6
MT	23	26	1
NB	96	192	6
NV	40	40	11
NH	125	15	2
NJ	205	141	5
NM	103	67	3
NY	272	269	38
ND	16	10	
OH	675	700	4
OK	731	674	6
OR	157	167	2
PA	719	596	22
SC	765	765	6
TN	477	466	6
UT	91		1/4
VA	390	303	4
VT	2	2	1
WA	178	349*	4
WI	248	117	5
WY	91		1

*Mostly Office Exams

It should be noted that these figures do not include informal settlements of findings of alleged violations.

C. VIOLATIONS AND COMPLAINTS

The Bureau's questionnaire sought to elicit information on regulators' most commonly uncovered finance company violations and consumers' most common complaints, if different. Listed below are the various states' responses:

MOST COMMON VIOLATION

1.	INSURANCE (REBATES & OVERLOADING)	20
2.	CALCULATION ERRORS	9
3.	LACK OF REGULATORY KNOWLEDGE	6
4.	RELEASING SECURITY	4
5.	LATE CHARGES	3
6.	PREPAYMENT PENALTIES	2
	TOTAL RESPONSES	44

*Some states listed more than one violation in answering this question.

MOST COMMON CONSUMER COMPLAINT

1.	RULE OF 78's PAYOFF	12
2.	COLLECTION PRACTICES	10
3.	RATES CHARGED	9
	TOTAL RESPONSES	31

With regard to the regulators' findings, it is significant to note that continuous refinancing of loans was not listed as a violation or important problem. In the case of consumer perception, the Rule of 78's method of calculating unearned finance charges and insurance premiums in the case of prepayment or refinancing of precomputed transactions, was the most commonly reported consumer complaint. It is worth noting that Maine has prohibited the Rule of 78's in credit contracts since 1982. (See Section V for discussion of other provisions of Maine law designed to prevent consumer abuse.)

D. TRENDS IN FINANCE COMPANY LENDING PRACTICES

The last section of the Bureau's questionnaire sought regulators' perception of trends developing in finance company lending practices. Some clearly marked trends emerge. The most widely reported was that of the greater minimum loan size. The range of the 34 responses to this question was from a low of $100 to a high of $5,000 with the average loan size in the $2,000 range. Sixty-eight percent (68%) saw average loan sizes increasing; 14% saw them decreasing and 19% reported no change.

This disparity of opinion may be explained by the fact that in some states finance companies are moving heavily into second mortgages. Because of the greater amount of money typically being borrowed on a second mortgage, overall average loan sizes would rise. In other states, smaller loans were being seen because of the decrease in finance companies' cost of funds.

Another trend noted was the increase in open-end financing, in part brought about by the promotion of the home equity credit line product.

A less clear trend noted was a decline in secured loans. Many attributed this to the FTC's Credit Practices Rule which prohibits the taking of security interests in household goods. However, nearly 50% of the 32 respondents noted an increase in secured loans, again attributable to the promotion of home equity credit lines.

The questionnaire concluded by asking regulators for their assessment of whether all creditworthy segments of their society were receiving credit. The clear response was yes, indicating that in those states where a broad spectrum of financial service providers operate, all creditworthy segments are served. (It was acknowledged by several that the price for such credit was in some cases very steep (up to 36%), but the marginal borrower always pays more.)

In marked contrast was the response from the State of Michigan, where finance companies have declined by more than 80% in the last six years due principally to a sharp reduction in finance charges allowed on small loans. (The rate now is 31% up to $500, 13% from $501 to $3,000; or 18%.) John W. Drury, Director of the Consumer Finance Division of the Michigan Department of Commerce estimated that one-third of the State's population was not being served now, and reported an increase in loan sharking, particularly in inner city areas.

SECTION IV

THE CONSUMER FINANCE INDUSTRY: AN OVERVIEW [19]

The consumer finance industry is defined to include those corporations, partnerships or proprietorships whose primary purpose is to provide credit to consumers. Such financing is done through direct cash loans or through the purchase of installment sales paper from dealers or retailers when consumers buy automobiles or other goods for which they pay over time.

The institutions specializing in this business are generally known as consumer finance companies, sales finance companies, industrial banks, and industrial loan companies. At the end of 1984, such companies held $96.7 billion in installment credit outstanding, approximately $20.8 billion in personal loans, $54.6 billion in automobile credit, $9.2 billion in mobile home credit, and $12.1 billion in credit to finance the purchase of other consumer goods and home improvements. (For a comparison with more current, but less detailed figures, see Appendix 13.)

In terms of overall debt, consumers' direct borrowings amounted to almost $2 trillion at the end of 1984. Approximately 70% of households' indebtedness was in the form of home mortgages. About 24% was in the form of installment consumer credit, defined by the Federal Reserve as "most short- and intermediate-term credit extended to individuals through regular business channels, usually to finance the purchase of consumer goods and services or to refinance debts incurred for such purposes, and scheduled to be repaid (or with the option of repaying) in two or more installments." About 6% of consumer debt was noninstallment consumer credit.

A. Size and Ownership

Finance companies vary in size and ownership from single office independently owned and operated companies to large chain companies with hundreds of offices across the country. Some medium-size and large companies are independently owned, others are subsidiaires of manufacturers, bank holding companies, insurance companies, or conglomerate firms. Alternatively, some companies in the industry have insurance and retail subsidiaries, some offer commercial financing, in addition to consumer financing, some have manufacturing subsidiaries and some have subsidiaries which operate in Canada and overseas.

For example, Beneficial Corp. has nearly $7 billion in receivables and last year earned $101.2 million on revenues of $2.1 billion making it the largest of the independent consumer finance companies.[20]

Beneficial is also active in buying the receivables of other lending institutions. Beneficial National Bank (U.S.A.) of Wilmington, Delaware, recently purchased the 86,000 account revolving credit portfolio of California Federal Savings and Loan Association, which is the fourth largest thrift institution in the nation. This portfolio is worth about $32 million.[21] In addition, Beneficial National Bank has also agreed to purchase a $35 million, 50,000 account, VISA Credit Card loan portfolio from American Savings and Loan Association of Utah.[22]

Further, Beneficial now does the bulk of its business in second mortgages and has $3 billion of outstanding loans making it one of the largest lenders in this field.[23]

At the other extreme might be the H. H. Stecher Finance Company of Haven, Kansas, which serves a population of 1,146. (For a more detailed discussion of the lending practices of finance companies in one state, see subsection J, infra.)

B. Long-Term Trends

Until well into the 1960's, finance companies were generally highly specialized and could be distinguished as consumer finance companies, sales finance companies or commercial finance companies. However, by the late 1970's, most large and medium-size, and many small finance companies had become more diversified, both as to lending (assets) and as to sources of funds (liabilities). During the 1970's, diversified giants from outside the industry recognized finance companies as well-managed profit centers and many finance companies were acquired by such conglomerates. Also, the passage of the Bank Holding Company Act amendments of 1970 provided the legal basis for bank holding companies to increase their acquisitions of finance companies.

At the end of 1984, consumer receivables constituted 42% of the $231.9 billion in receivables, while business credit in the amount of $135.2 billion constituted 58%.

When the estimated amount of second mortgage personal loans outstanding at finance companies at the end of 1984 ($26.3 billion) is included as consumer credit, the distribution between consumer and commercial credit outstanding becomes 48% and 52%.

The financial integrity of the industry is becoming stronger all the time. According to Moody's and Standard Poor's, there are now more "Triple A" rated finance companies than there are "Triple A" bank holding companies.[24]

C. Types of Consumer Finance Business

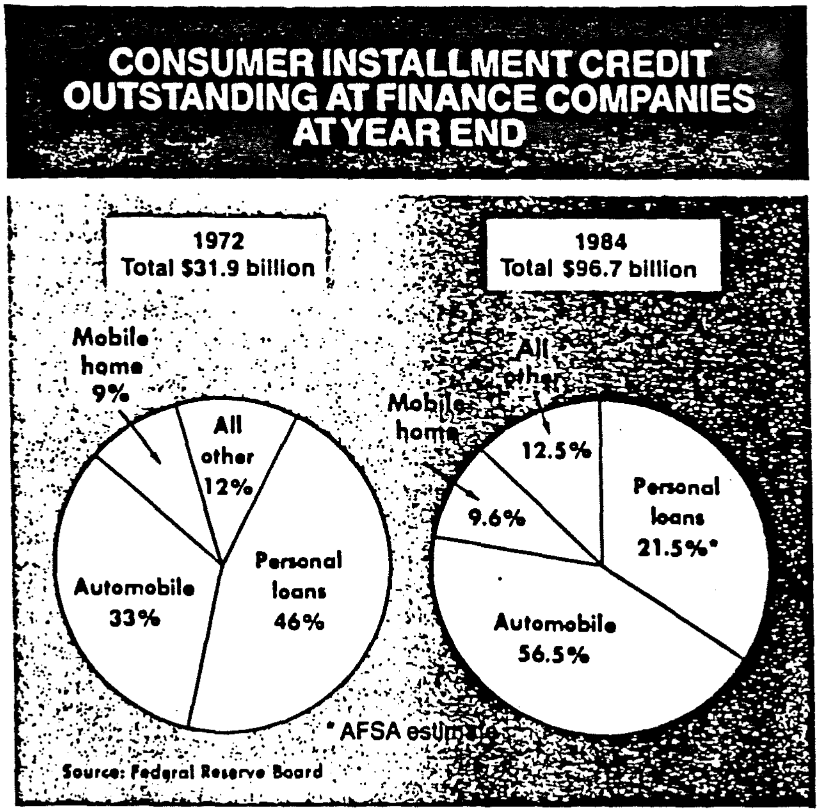
At the end of 1984, the $96.7 billion in consumer installment credit held by finance companies consisted of approximately $20.8 billion in unsecured personal loans (22%), $54.6 billion in retail automobile paper (56%), $9.2 billion in mobile homes (almost 10%), and $12.1 billion in other forms of consumer installment credit (12%). The vast majority of finance companies now offer a diversity of these consumer credit services. (See Exhibit 7)

Although most finance companies and industrial banking companies now in operation had their early beginnings in the direct cash loan field, many others started in the retail sales financing business. Most have subsequently added the other services as a means of providing more complete service for existing customers or as a means of attracting new customers.

Financing of automobiles and other consumer durable goods, the speciality of the sales finance company, is frequently a marginal profit activity, nearly always requiring a large volume for success. Particularly in the financing of relatively small purchases, the total income from finance charges barely covers the cost of putting an account on the books, and is often inadequate to cover the cost of servicing over a period of months or years.

Revolving or open-end consumer credit business has been growing but is still not a major element for most finance companies, partially because of restrictive legislation. However, with the increasing use of electronic fund transfers, many companies are showing an interest in expanding this type of service.

Exhibit 7



Real estate secured loans as a percentage of personal loans have been increasing rapidly. The Federal Reserve Board estimated that the total of second mortgage loans outstanding at finance companies at the end of 1984 was $26.3 billion. In a selected sample of finance companies compiled by the American Financial Services Association, it was shown that second mortgage loans comprised 6% of total consumer receivables (at $2.1 billion) in 1977, rising to 16% (at $13.8 billion) in 1983. (June, 1986 statistics prepared by the Federal Reserve Board show second mortgage loans at all finance companies to be $32.4 billion, approximately 19% of all consumer debt outstanding. See Appendix 13.)

D. Average Loan Sizes

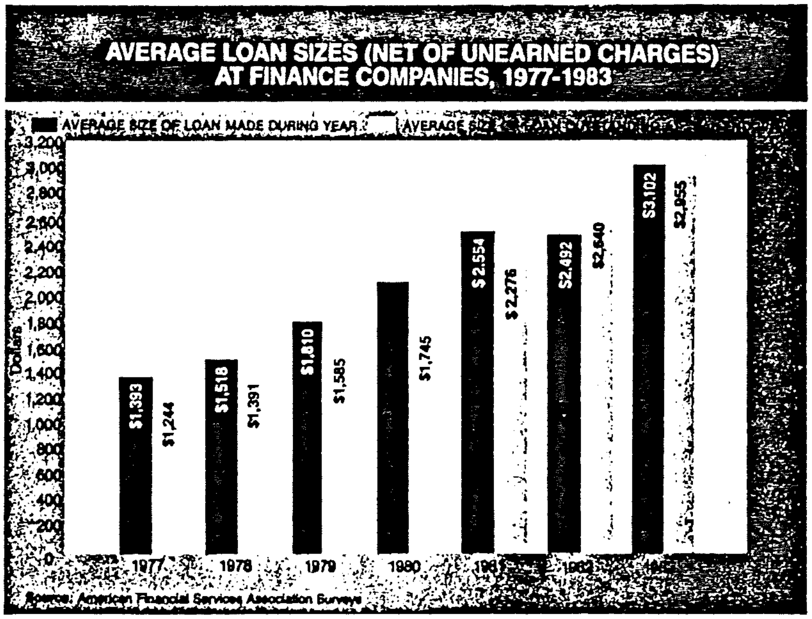
Loan ceilings, loan demand and rates allowed influence the size of loans made. Finance companies generally try to offer full loan service. That is, they try to serve customers who need both small and large loans. However, the yield on small loans can be considerably below the cost of making the loan, making it economically difficult for any institution to have a very large proportion of loans outstanding in the form of very small loans. Rising consumer prices, however, have reduced the consumer demand for very small loans, alleviating this problem somewhat.

According to AFSA surveys of member finance companies, the average size second mortgage personal loan made (at 64 responding companies) in 1983 was $14,818 (excluding unearned charges). This compares with an average non-second-mortgage personal loan size of $1,914. (See Exhibit 8 .)

The same 64 companies also provided sufficient detail to show average size second mortgage loans outstanding of $12,480 and average size non-seconds outstanding of $1,572.

Automobile finance contracts are on average much larger than (non-second-mortgage) personal loans. Federal Reserve data reveal that the average amount financed on new automobiles (again excluding precomputed charges) increased from $8,787 in 1983 to $9,333 in 1984. For used cars, the amount advanced by finance companies increased from $5,033 in 1983 to $5,691 in 1984. (Maine had over 1,000 used car dealers many of whom cannot find financing for their customers at banks or credit unions.)

Exhibit 8


AVERAGE LOAN SIZES (NET OF UNEARNED CHARGES)
AT FINANCE COMPANIES, 1977-1983
AVERAGE SIZE OF LOAN MADE DURING YEAR
Dollars
3,200
3,000
2,800
2,600
2,400
2,200
2,000
1,800
1,600
1,400
1,200
1,000
800
600
400
200
0
$1,393
$1,244
$1,518
$1,391
$1,810
$1,585
$1,745
$2,554
$2,276
$2,492
$2,640
$3,102
$2,955
1977
1978
1979
1980
1982
Source: American Financial Services Association Surveys

E. Average Rate Charges

Federal Reserve data reveal that finance companies charged an overall average rate of 23.1% on loans made in 1982 (the last date for which rates were collected).

Large ticket items such as automobiles, which have a resale value, can usually be financed at lower rates. According to Federal Reserve surveys, the average annual rate charged by finance companies in 1982 for financing of new autos was 15.8% and for used autos was 20.8%. Finance company rates for mobile homes averaged 18.8% in 1982. Financing of consumer goods other than autos and mobile homes, specifically items of less cost and not usually resalable cost an average of 22.6% per year at finance companies in 1982.

F. Profile of Borrowers

Traditionally, the "character" of the borrower was the significant factor considered by finance companies granting loans, although increasing emphasis has been placed on real property security in recent years.

While less detailed information on the purposes of second mortgage loans made at the finance companies responding to the AFSA survey in 1983 is available than on the purposes of other personal loans, what information that is available reveals is that the vast majority (98%) of real-estate secured loans were taken for uses not involving the purchase or transfer of real estate. More specifically, seconds are now being used primarily to finance such activities as vacations, college tuition, home improvements, etcetera. A large portion (around 20%) of the smaller other personal loans are still used to consolidate and/or refinance existing debts.

The characteristics occurring most often among the second mortgage customers of the surveyed companies include: age between 35 and 44 years, annual income over $24,000, occupations are operatives, laborers, managers, proprietors etc. Second mortgage loans are made most frequently in amounts between $5,000 and $10,000 (net of unearned charges). For other personal loan borrowers: age is younger, most frequently between 25 and 34 years, and annual income is lower, between $15,000 and $24,000. Occupations are again most frequently operatives, laborers, clerks, etc. and loans are most frequently made in net amounts between $2,000 and $5,000. Exhibit 9 provides the income and age distributions of the 85,407 U.S. households in 1983 for purposes of comparison. Although the income brackets are slightly different, general comparison is possible. The most common household income in the overall population was between $30,000 and $40,000 and the most common age of householder was between 25 and 34.

Exhibit 9

PERCENTAGE DISTRIBUTION OF U.S. HOUSEHOLD POPULATION
BY ANNUAL INCOME AND BY AGE, 1983

By Annual Income	
$5,000 or less	9.2%
$5,001 to $10,000	13.7%
$10,001 to $15,000	13.0%
$15,001 to $20,000	12.0%
$20,001 to $25,000	10.8%
$25,001 to $30,000	9.2%
$30,001 to $40,000	13.7%
$40,001 to $50,000	8.1%
$50,001 to $75,000	7.4%
Over $75,000	2.8%
Total	100%
Mean household income	$25,401
By Age of Householder	
Less than 25 years	6.5%
25 to 34 years	23.2%
35 to 44 years	19.4%
45 to 54 years	14.6%
55 to 64 years	15.4%
65 years and over	21.0%
Total	100.0%

Memo: Total number of households 85,407

Source: Bureau of the Census.
Note: Parts may not add to totals due to rounding.

Exhibit 10

PERCENTAGE DISTRIBUTION OF LOANS MADE AT FINANCE COMPANIES
IN 1983, BY CHARACTERISTICS OF BORROWERS

	Percent of Number of Loans Made to:	
	Second Mortgage Personal Loan Borrowers	Other Personal Loan Borrowers
By Annual Income		
$6,000 or less	1.5%	1.1%
$6,001 to $9,000	2.4%	3.7%
$9,001 to $15,000	17.7%	29.8%
$15,001 to $24,000	29.4%	30.5%
Over $24,000	45.6%	29.2%
Not reported	3.5%	5.7%
Total	100.0%	100.0%
By Age		
Less than 25 years	1.9%	10.0%
25 to 34 years	20.4%	36.6%
35 to 44 years	34.3%	25.8%
45 to 54 years	25.9%	16.0%
55 to 64 years	15.0%	9.7%
65 years and over	2.2%	1.8%
Not reported	0.2%	0.2%
Total	100.0%	100.0%

Source: American Financial Services Association.

G. Borrower Attitudes Toward Finance Companies

A recent focus group on consumer reaction to finance companies turned up some surprising results which lend support to the rationality of doing business with lenders that may be more expensive than competitors.

Market Facts, a Chicago-based market research firm, randomly selected 13 customers of consumer finance companies (from more than 230,000 people who had completed lengthy questionnaires) to discuss how they felt about finance companies.[25] Occupations of the group included a truck driver, a registered nurse, a school teacher, a computer programmer and a beautician. The discussion was filmed live and watched through closed-circuit television. Participants did not know they were being observed; although they knew they were being filmed.

To summarize the discussion, only two of the 13 panelist had complaints about finance companies and in both cases they involved contracts that had been assigned to a finance company by a retailer.

The common threads that ran through the discussion were:

(1) Finance Companies are interested in individuals; banks are not.

(2) Finance Companies offer same day loan service, banks often take up to three days and then deny the loan.

(3) Finance Companies are "friendly;" banks are "stuffy."

Satisfied finance company customers are also quick to recommend a company to friends. One man reported that he has sent over a half million dollars worth of business to a particular finance company because of his own personal satisfaction.

While these findings are hardly more than anecdotes, they do illustrate that service and treatment received by consumers are important in choosing a lender. Price of the loan is not the only criterion consumers evaluate.

H. Maine Merchants' Reaction to Finance Companies

In October, 1986 the Bureau of Consumer Credit Protection conducted a brief survey of small merchants and automobile dealers regarding their opinion on credit availability and their attitude toward finance companies. (See Appendix 14 for copy of questionnaire.)

One hundred merchants and dealers were surveyed, with representatives from each of Maine's 16 counties. Recipients of questionnaires were chosen based on credit volume of $1 million or less reported to the Bureau in 1986. Self-addressed, pre-paid reply envelopes were enclosed with the questionnaire. Sixty-two responses were received.

One question asked if their customers' financing needs were being served by current credit sources. Forty-six respondents answered the question, and 31 said yes. Put another way, of those who had an opinion, 15, or 33% felt that their customers' credit needs were not being served. Even if a non-response was treated as an affirmative response, there would still be roughly 25% of all respondents of the belief that there is not adequate credit availability.

Although it has been nearly a decade since the last major finance company left Maine, the respondents were asked if they had ever had dealings with a finance company and to comment on whether this experience was favorable or unfavorable. In light of the high degree of emotionalism that surrounded finance company activity in the mid-1960's, it was assumed that memories would be long in the event of unpleasant dealings and that respondents would be quick to note any negative experiences.

Surprisingly, of the 33 respondents who reported having had dealings with finance companies in the past, 29, or 88%, reported the transactions as favorable.

A final question was asked as to whether the return of finance companies to Maine would be beneficial to the respondents or their customers. All 62 respondents answered this question. Thirty-five (35) or 56% favored the return; 21 or 34% were opposed to the return; and 6 or 10% were undecided or had no opinion. Considering that 29 respondents did not answer the previous question, virtually all of the negative responses to the question on the return of finance companies can be attributed to respondents who had no experience with them. (This seems to follow the widely held belief of many Mainers that finance companies are "bad" even though many who hold that opinion have no actual experiential basis for it.)

I. Impact of Strong Trade Associations; Codes of Ethics

While most Codes of Ethics are dismissed by cynics because the Codes carry no punishment for violation, the cynicism is by no means fully deserved. Such Codes serve to raise the consciousness of members of the subscribing organization, can be means to exclude would-be members from an organization if they will not adhere to them, and can be the basis for expulsion from membership in egregious cases.

The American Financial Services Association, the national trade association of the consumer finance industry, has two Codes that members must subscribe to. The first, the Code of Ethics, relates to fair dealing with customers, fair advertising and cooperating with regulatory bodies and private consumer and business organizations in seeing credit laws effectively enforced.

The second code, the Collection Code, is basically a recapitulation of the key provisions of the Federal Fair Debt Collection Practices Act (now part of Maine law at 32 M.R.S.A., c. 111.) Neither the federal nor state Act applies to creditors collecting their own debts - the Acts only apply to third party debt collectors. Thus, but for a creditor's voluntary compliance with such standards, there would be no way to enforce the law on that creditor. (See Appendix for the text of both Codes.) To the extent that abusive debt collection practices were one of the bases for the opposition to finance companies in Maine, the development of Codes such as this may help to prevent the recurrence of such abuses.

AFSA has 550 members who collectively operate more than 11,000 consumer finance offices throughout the United States.

J. Would Finance Companies Return to Maine? The Kansas Experience

While there is no guarantee that finance companies would return to the smaller and or geographically distant cities of Maine if the regulatory climate becomes more favorable, the current situation in another comparable state of which data are available may serve as a "crystal ball" of what might happen here.

Kansas, with a population of 2,365,000 and an area of 81,787 square miles, is larger in area and less densely populated than Maine with a population of 1,105,200 and an area of 30,920 square miles.

Kansas is also, like Maine, one of nine states that has adopted the Uniform Consumer Credit Code. In fact both Maine and Kansas have adopted the most recent version of the UCCC, the 1974 version, so both states' credit laws are remarkably similar.

As of December, 1985, Kansas had 231 finance company offices in the state operated by 34 multi-state companies and 28 local companies. The population of the 46 communities that were served by finance companies ranged from Wichita with 269,100, to Haven with 1,146. As can be expected, the major population areas are served by the large national finance companies such as Beneficial, Household Finance and Sears while the smaller communities such as Haven (mentioned above), Fort Scott (population 8,967) and Norton (population 3,627) are served by one of the 28 independent operators.

In its Thirtieth Annual Report, the Office of Consumer Credit Commissioner for Kansas provides an analysis of consumer loans by size and type of security as of December 31, 1985, an excerpt of which is reprinted below.

ANALYSIS OF CONSUMER LOANS BY SIZE
December 31, 1985

	Number	Percent of total number	Amount	Percent of total
Loans made during the year:				
Loans of $500 or less	11,259	12.76%	$ 3,424,575	1.45%
Loans of $501 to $1,800	35,041	39.72	37,675,363	15.92
Loans of $1,801 to $5,000	34,998	39.67	96,551,236	40.81
Loans of $5,001 to $10,000	3,721	4.22	26,873,256	11.36
Loans above $10,000	3,208	3.63	72,075,335	30.46
Total loans made during the year	88,227	100.00%	$236,599,765	100.00%
Loan balances charged off during the year	5,254	5.96%	$ 13,978,611	5.91%

ANALYSIS OF TYPES OF SECURITY

	Number	Percent of total number	Amount	Percent of total
Loans made during the year secured by:				
Household goods	18,730	21.23%	$ 31,214,586	13.19%
Automobiles	8,820	10.00	30,391,312	12.85
Household goods & automobiles	3,777	4.28	11,504,611	4.86
Signature	30,076	34.09	51,669,725	21.84
Real Estate	6,350	7.20	78,712,427	33.27
Other	20,474	23.20	33,107,104	13.99
Total	88,227	100.00%	$236,599,765	100.00%

Of considerable interest in the Analysis of Consumer Loans by size are the two initial entries under "Loans made during the Year." Twelve point seven six percent (12.76%) of the total number of loans made were $500 or less and 39.72% were loans between $501 and $1,800. These two entries reflect that more than 50% of the <u>number</u> of consumer loans made by finance companies in Kansas were $1,800 or less.

In the second block, "Analysis of Types of Security," it is interesting to note that Signature loans, which are loans unsecured by goods, represented 34.09% of all loans made - the largest single category of the number of loans made. Such loans were second only to Real Estate loans in terms of dollar amounts - $51.7 million for Signature compared to $78.7 million for Real Estate.

In addition to its finance companies, Kansas like Maine has a number of federally and state chartered credit unions. At year end 1985 its 209 credit unions (including branches) had $722.5 million in loans outstanding for a per capita loan figure of $306.00. This compares favorably with Maine's 144 credit unions (including branches) with $382.1 million outstanding for a year capita loan figure of $346.00

From this brief look at the data, it becomes apparent that finance companies with total loans made during the year of $236.6 million are playing an important role in serving the needs, particularly the small loan needs, of the widely dispersed population of the State of Kansas and that they are able to coexist with credit unions, each effectively serving a segment of the borrowing community.

SECTION V

CURRENT STATUTORY PROTECTIONS AND OTHER LEGISLATIVE ALTERNATIVES TO PREVENT OR DETER RECURRENCE OF FINANCE COMPANY ABUSES

As mentioned in Section I, subsection A of this Report, there were several abuses in the small loan industry that generated the opprobrium against them. While this report primarily concerns the practice of continuous loan refinancings, it is important to understand the other statutory protections that now exist that would prevent, or certainly deter, the other abusive practices that were of concern to the Legislature in the 1960's.

A. ABUSIVE INSURANCE PRACTICES

1. Overcharging for Insurance Products: In the mid-1960's (and apparently before), it was quite common for loan companies to sell credit insurance products, such as credit life, accident and health insurance, and property insurance to consumers in connection with a loan, at a price in excess of the actual premium charged by the insurer.

Section 4-107(1) of the Code now effectively prevents this by limiting the amount a creditor can charge for insurance to "the premium charged by the insurer, as computed at the time the charge to the consumer is determined, conforming to any rate filings required by law...." In short, no "mark ups" are allowed by the creditor in selling credit insurance. If such charges are imposed, they are considered excess charges which the consumer can recover in a civil action (or, in lieu of damages, civil penalties of between $250 and $1,000) under §5-201(1). The Bureau can also order refunds administratively under §6-108, or seek judicial relief under §§6-110 through 6-113.

2. "Packing" Expensive Accident and Health Insurance: Because creditors earn commissions as insurance agents in the sale of credit insurance, there are strong incentives to sell insurance and to sell expensive insurance.

(This phenomenon is referred to as "reverse competition" -- where there is an incentive to sell the most expensive product because it is the basis for the commission earned.) In the case of accident (disability) and health insurance, creditors were selling products with minimal waiting periods (usually 7 days), which carried extremely high premiums. Because consumers usually did not understand what they were buying to begin with, they did not comparatively shop for insurance and accepted what the creditor offered which was very expensive.

In 1967 this was corrected. That protective legislation has been carried forward into the Code at §4-104(3). Maine law now prohibits the sale of A&H insurance in credit sales and closed end loans (above 12 1/4%) unless the consumer's minimum monthly payment obligation is at least $30, or unless the loan has a duration of at least 18 months. (In other words, such insurance cannot be sold on small credit transactions.) Further, any A&H product that is sold must have a waiting period of 30 days. Creditors may offer products with retroactive application but the cost thereof must be clearly disclosed.

3. Unnecessary or Useless Property Insurance: Again, because the sale of insurance represents a significant profit center in a creditor's business, there was strong incentive to sell as much of it as possible. Frequently, loan companies which took a security interest in the consumer's household goods to secure a loan, would then sell property insurance on such goods. Loan companies rarely, if ever, exercised their right to repossess household goods if a consumer defaulted on a loan. The retention of a security interest in such goods had an in terrorem effect, however, prompting payment. The sale of insurance on such goods was, then, largely unnecessary, except from a

profit standpoint for the creditor. By virtue of the adoption of the Credit Practices Rule (16 CFR 444) in 1985, creditors are now prohibited from securing loans with household goods.

Property insurance can still be sold on goods that are being financed through the particular consumer credit transaction, however. Maine law, §4-301, now imposes a number of preconditions on the sale of such insurance that are protective of consumers. First, such insurance cannot be sold unless the amount financed in the loan or credit sale is $1,000 or more. Second, before such insurance can be sold it must cover a substantial risk of loss or damage to the property involved in the credit transaction, and its amount, duration and terms must be reasonable considering what is being insured. (By Bureau Rule 140, the Bureau has determined that these tests have not been met if the creditor sells insurance that is largely duplicative of any homeowners-type insurance the consumer already has, that the creditor knew of or could have easily learned existed.)

4. <u>"Packing" Insurance Generally</u>: A common problem in the 1960's, and one that still exists today in other states (<u>see</u> §III C, <u>supra</u>), is the practice of selling all forms of credit insurance (packing) with a loan. Often times consumers are completely unaware they are buying such insurance, mistakenly assume they must buy it, or believe they had better buy it or risk not getting the loan.

Maine law, §2-501(2), requires certain disclosures before such insurance can be sold. In the case of property or liability insurance, <u>which the creditor can require</u>, consumers must be informed that if such insurance is a condition of a loan they can purchase it anywhere and not just from the creditor. Credit life and A&H insurance, which cannot be required, can only be sold by the creditor if (a) it is made clear such insurance is optional, (b) the cost of the insurance is disclosed and (c) the consumer gives his affirmative indication he wants the insurance. (Parallel provisions exist in §8-105 of the Code, Maine's Truth-in-Lending provisions.) While these disclosure provisions can still be circumvented or negated through a combination of fast-talking salespeople and careless consumers (such as with instructions by the salesperson to "sign at all the x's"), the disclosures do help many consumers. Moreover, the disclosures give the Bureau the legal basis to undo certain insurance sales if the law was violated or circumvented.

5. <u>Worthless Insurance Products</u>: While this issue was not a reported problem in the mid-60's (other than criticism of the value of certain "conventional" forms of insurance), it has been more of a problem of late in other states. Regulators in those states have criticized finance companies for selling dubious forms of credit insurance. Section 4-106 of the Code provides some protection against this occurring in Maine. The section allows a Maine court to determine that a particular form of insurance is unconscionable if it finds that the potential benefits to the consumer are minimal, that the creditor's need for protection against the insured risk is minimal and the terms of the credit transaction versus the benefits provided by the insurance are not fair. If the insurance is found to be unconscionable, the court can reform the agreement and return premiums.

6. <u>Use of Rule of 78's in Calculating Unearned Insurance Premiums</u>: The Rule of 78's, also known as the "sum of the digits method," allows a creditor or insurer to consider a greater proportion of interest or premiums paid to be earned in the early term of the contract than would

be the case if one applied the total interest or insurance charge to the number of days the contract had been effect (the actuarial method). The Rule of 78's hurts consumers (by costing them more) when a loan is paid off early either by prepayment or refinancing. Maine prohibited use of the Rule of 78's in credit transactions effective January 1, 1982 (§2-510), but still allows its use for calculating unearned insurance premiums in cases in which the policy duration is 48 months or less. However, the Bureau of Insurance is currently in a rulemaking proceeding (Rule 220) in which, among other things, the Rule of 78's will be prohibited entirely. Thus, any unfairness worked by the Rule of 78's should be completely eliminated from Maine consumer credit insurance products shortly.

B. Unfair Debt Collection Practices

Another criticism of finance company practice in the mid-60's was abusive debt collection practice, particularly the threat to jail debtors for unpaid debt, as was allowed. In 1971 Maine's "debtors' prisons" were eliminated, thereby reducing one form of abusive treatment.

With the enactment of the Code in 1974, several more prohibitions against "illegal, fraudulent or unconscionable" conduct in debt collection by creditors were added. Section 5-116 prohibits in debt collection:

-the use or threat to use force or violence;

-the threat of criminal prosecution;

-the disclosure of, or threat to disclose, false information about the debtors' creditworthiness;

-the communication with, or threat to communicate with, the debtor's employer more than twice about the consumer's debt, even after obtaining a judgment (except as may be allowed by other law);

-the disclosure of, or threat to disclose, to third parties who do not have a legitimate business need, information about the debtor's reputation;

- the disclosure of, or threat to disclose, information about the consumer's debt that the creditor knows to be disputed, without revealing that it is disputed;

- the enforcement of, or attempt or claim to enforce, a right to the debt that has been barred by law; and

- the use of a communication which appears to be issued from a government agency or attorney.

If a creditor violates any of these provisions he is liable to the consumer for damages, or civil penalties of between $250 to $1,000, plus attorney's fees and court costs.

Further, other provisions of Maine law provide protection that may not have been available in the 1960's: notice of right to cure default before acceleration or repossession; prohibition on the imposition of attorneys' fees and collection costs; restrictions on deficiency judgments; etc.

C. Continuous Refinancings

Leaving aside for a moment the impact of the 37 month rule (which only applies to loans above 18%), there are several other provisions of Maine law that have a protective bearing on the practice of continuous refinancings.

1. Jumping Interests Rates Upon Refinancing:

Section 2-504 limits a creditor from increasing the interest rate on a refinancing by more than 1%. Should a consumer have a relatively low interest rate on an obligation sought to be refinanced, the creditor could not boost the rate significantly at that time. (However, it should be noted that if the creditor advances new money thereby creating a new obligation, this restriction does not apply.)

2. Profiting from Serious Delinquency:

Maine is among a handful of states that prohibits unpaid interest on seriously delinquent loans from being incorporated into interest-bearing principal in a refinanced loan. (The others are Florida, New Hampshire, Rhode Island and South Dakota.) Section 2-401(3) allows a maximum of 60 days' unpaid interest to be incorporated as principal into a new loan. This would thus be a disincentive to a loan company to allow loans to become seriously delinquent and then to refinance them.

D. Loan Splitting

The practice of making multiple loans to an individual, or to a husband and wife, by a finance company or its subsidiary, or both, is prohibited in Maine. The technique was used simply to take advantage of higher interest rates on small loans, versus a lower rate that would be required on one larger loan.

For example, §2-401 of the Code allows rates of up to 30% on loans of up to $700. For amounts above $700, but not above $2,000, the rate drops to 21%. If a lender made two $700 loans for 24 months he would earn $478.24 in interest (APR 29.98%). If he made one $1400 loan for 24 months, he would only earn $431.92 in interest (APR 27.28%), $46.32 less. There is obviously an incentive to split loans.

Section 3-304 prohibits loan splitting and creates a rebuttable presumption that a lender is using multiple agreements to circumvent the law if (a) he has more than one over - 18% loan with a customer and (b) a significant portion of his loan business involves loans above 18%. If the presumption is not rebutted the consumer can recover the excess charge or civil penalties of between $250 and $1,000 in a civil action. The Bureau also has administrative authority to order refunds.

E. Alternatives to the 37-Month Rule

The 37-Month Rule is basically an "interest after maturity" law, but with a very hard twist. First, the law does not tolerate refinancings that will cause a loan with a rate in excess of 18% to extend beyond 37 months. At that point the rate drops to 8%. Second, the original loan, and any additional loan that the finance company has with the consumer, regardless of the rate, drops to 8%.

Nine other states have interest after maturity provisions in their small loan laws. In no case is there a prohibition on refinancings or a provision requiring other loans with that customer to suffer the rate reduction. Most of these nine states have maximum maturity provisions for small loans, but also allow legitimate refinancings to start the time clock over.

The nine states are:

Alabama	8% per year 6 months after maturity
Connecticut	12% per year after maturity
Florida	10% per year 12 months after maturity
Maryland	6% per year 6 months after maturity
Massachusetts	12% per year 12 months after maturity
New Hampshire	12% per year 3 months after maturity
New Mexico	10% per year 12 months after maturity
North Carolina	8% per year after maturity
Virginia	6% per year 6 months after maturity

In view of the fact that not one of the states responding to the Bureau's survey mentioned continuous refinancings as a problem with modern day finance companies, one could conclude that the problems evident in the mid-60's in Maine are not likely to recur. Further, because there can be many legitimate reasons why a loan might be refinanced, such as need for new money or financial emergency requiring the loan term to be extended to lessen payments, there seems to be little reason to retain a provision in Maine law that punishes a lender for allowing an above-18% transaction to run beyond 37 months (or conversely, prohibits a consumer from obtaining such a loan).

It is not unreasonable, however, to retain an interest after maturity provision. Such a provision punishes the creditor who allows a loan to become seriously delinquent and also provides relief to the consumer who, for whatever reason, does not make payments as agreed and gets well behind in his payments. As noted, nine other states, three of which are New England states, have such provisions in their laws.

If one accepts that an interest-after-maturity provision is warranted, but that a 37-month maximum on loan duration (including refinancings) is not, it is illogical to retain the provision of Maine law that requires any additional loan agreement between the customer and finance company to suffer a penalty rate. The current law makes no distinction as to what the rate or rates happen to be on those transactions, when the transactions were entered into, or what the repayment experience had been. The current law paints with a broad brush, suggesting that all transactions between consumer and lender are detrimental to the consumer and should be reduced in rate.

If the Committee determines that the present law is deserving of modification, the Bureau would recommend the following alternatives:

> Be it enacted by the People of the State of Maine as follows:
>
> 9-A M.R.S.A., §2-308, sub-§3, as enacted by P.L. 1973, c. 762, §1, is repealed and the following enacted in its place:
>
> 3. <u>No consumer loan on which the annual percentage rate disclosed is greater than 18% may provide for a rate greater than 8% per year on the unpaid balances of the principal remaining unpaid at the expiration of six months after the scheduled maturity date of that loan. No loan may be deferred, renewed, refinanced, or consolidated to circumvent or evade the provisions of this subsection. The administrator shall, by rule, identify those practices which constitute prima facie evidence of circumvention or evasion of this subsection.</u>

This proposal allows consumer and lender to establish whatever maturity they want on an above-18% transaction (just as they can on a below-18% transaction now). The law keeps the interest-after-maturity concept by requiring a rate reduction to 8% if the loan remains unpaid six months after maturity. The law does allow refinancings which would have the effect of allowing the time clock to be reset. However, a refinancing, renewal, deferral or consolidation that was undertaken to circumvent the 8% rate reduction provision would be disallowed. The proposal directs the Superintendent to adopt rules on circumvention, specifying the types of behavior that would be subject to challenge. Finally, this proposal does not subject other loan relationships the lender has with the consumer to suffer the penalty rate if the interest after maturity provision happens to be triggered on a particular loan.

[It should be noted that by operation of §2-308 (1), a loan of $700 or less must pay out in no more than 25 months.]

While not being the final form a rule under §2-308(3) might take, listed below is a proposal that the Bureau feels would help flesh out §2-308(3) to prevent consumer abuse.

Summary: This rule sets forth those practices which constitute prima facie evidence of circumvention or evasion of the 8% per year interest rate reductions for consumer loans subject to Section 2-308, subsection 3 of The Maine Consumer Credit Code.

1. Consumer loans that are renewed three months or less prior to the 8% interest reduction date shall be deemed to be in circumvention of §2-308 if it can be demonstrated that:

A. The amount of the cash advance was negligible. For purposes of this Rule, a cash advance of $100 or less will be considered negligible.

B. On cash advances in excess of $100, the consumer did not initiate the request for additional funds and the funds were not for a specific, verifiable purpose.

C. A number of factors shall be considered to evaluate the criteria set forth in subsection B, including but not limited to the consumer's loan balance at the time of renewal, the history of repayment, the frequency in which the consumer's loan has been renewed in the past, the purpose of the renewal, whether or not the consumer was directly or indirectly coerced into renewing the loan and any other mitigating circumstances that have a direct bearing on the renewal.

2. During the three month period preceding the commencement of the 8% interest rate, the lender shall take reasonable steps to insure that the consumer does not receive any oral or written solicitation stating that further credit may be extended during this period.

The Rule would make it clear that a refinancing of a loan, within three months of the imposition of the penalty date, with only a modest amount of money would be evidence of circumvention. Further, if more than $100 was advanced, a case of circumvention could still be made out depending upon who initiated the request for funds, whether they were used for a specific purpose, what the consumer's loan balance was at the time, how the consumer had paid his loan historically, and how many other times the loan had been renewed.

Finally, to ensure that the Bureau has the ability to respond promptly to situations of abuse, it is suggested that license suspension power might be in order. Currently, under §2-303 of the Code, licenses can only be suspended by action of the administrative court. As noted in Section 3, subsection B, above, several state small loan licensing agencies have authority to suspend licenses for violations.

For many years Maine's position had been to clearly separate license-granting power from the power to suspend or revoke, presumably to ensure adequate due process when affecting significant property interest. However, in recent years, there has been some relaxation in this concern as evidenced by the willingness of the Legislature to grant <u>limited</u> license <u>suspension</u> authority to State agencies, for the sake of expediting effective enforcement of the law. (Because the licensee has the right to appeal any decision to court, his rights are still protected.) Several licensing boards, most notably the Real Estate Commission, can suspend licenses for up to 60 days administratively (and in the case of the Real Estate Commission, even impose fines, up to $500). The Secretary of State now handles driver's license suspensions; the Maine Bureau of Alcoholic Beverages can suspend liquor licenses for short periods for liquor law violations.

License suspensions for limited periods do not ultimately take away property rights; they merely punish by disallowing the continuation of business for a time for administratively determined violations. All suspension hearings would be conducted pursuant to the Administrative Procedures Act to ensure fundamental fairness. Because getting a case to the Administrative Court can be a lengthly process, effective enforcement of the law can be hampered through such delay, as well as by the allocation of resources to preparation of the case. Administrative suspension orders can achieve the same ends with less cost and in shorter time.

Finally, in light of the fact that §6-108(1) grants to the Administrator the authority to issue ex parte cease and desist orders (which clearly relate to the cessation of certain activity if not a license), there is already some precedent in the Code for strong powers in the Administrator.

The Bureau would recommend the following:

§ 2-303-A. Administrative license suspension

1. The administrator may suspend a license to make supervised loans, for a period not to exceed 60 days, if he finds after notice and opportunity for hearing, that the licensee has violated this Act or any rule made pursuant to this Act. Such authority to suspend a license shall be in addition to other rights of the administrator, including the right to seek suspension or revocation of a license through the Administrative Court, pursuant to §2-303.

2. No suspension of a license pursuant to this section may impair or affect the obligation of any preexisting lawful contract between the licensee and any debtor.

FOOTNOTES

1. George J. Benston, "An Analysis of Maine's "36 Month Limitation" on Finance Company Small Loans," - University of Rochester Graduate School of Management Reprint Series, (Dec. 1972), Chart 1, Number of Total, National and Local Companies and Offices Operating in Maine as of June 30, 1965 through 1972, p. 5.

2. House Legislative Record, 104th Legislature, p. 4256 (June 25, 1969) (remarks of Representative Cox - Bangor).

3. Benston, Op. cit. p. 9.

4. Senate Legislative Record, 103rd Legislature, pp. 3034-5 (June 8, 1967) (remarks of Senator Mills - Franklin).

5. House Legislative Record, 102nd Legislature, p. 216.

6. House Legislative Record, 103rd Legislature, p. 3324 (June 14, 1967).

7. Senate Legislative Record, 104th Legislature, p. 4076 (June 20, 1969) (remarks of Senator Barnes - Aroostook).

8. House Legislative Record, 104th Legislature, pp. 4259-60 (June 25, 1969) (remarks of Representative Henley - Norway).

9. Senate Legislative Record, 104th Legislature, p. 4076 (June 20, 1969) (remarks of Senator Levine - Kennebec).

10. For a detailed discussion of Professor Benston's methodology see Benston, Op. cit., pp. 33-35.

11. Ibid., p. 35.

12. Ibid., p. 37.

13. Jan Wong, "Takeover Frenzy Heats New England Banking," The Wall Street Journal, August 29, 1986, p. 6.

14. Constance R. Dunham, "Interstate Banking and the Outflow of Local Funds," New England Economic Review, Federal Reserve Bank of Boston, July/August 1986.

15. The Status of Maine's Financial Institutions, Maine Bureau of Banking, January 15, 1986, p. 56.

16. Statistics supplied by SRI International, a market research firm in Menlo Park, CA.

17. Statistics supplied by Bankcard Holders of America.

18. Ibid.

19. Unless otherwise noted, information in this section was derived from 1985 FINANCE FACTS YEARBOOK, published by American Financial Services Association, Washington, D.C. (1985), pp. 59-71.

20. "Beneficial: On the Block and Loving It," *Business Week*, September 8, 1986, p. 27.

21. "Beneficial Buys Portfolio," *Credit Week*, Vol. 10, No. 22, June 6, 1986.

22. *Ibid*., Vol. 10, No. 32, August 22, 1986.

23. Dexter Hutchins, "Beneficial: New Ways to Mass Market Loans," *Fortune*, October 28, 1985, p. 41.

24. Noel Delaney, "Wall Street and Finance Companies," *Credit*, July/August 1986, p. 14.

25. "Consumers Talk," *Credit*, July/August 1986, pp. 10-11.

Appendix 1

SENATE

BEVERLY MINER BUSTIN, DISTRICT 19, CHAIR
DAVID T. KERRY, DISTRICT 31
CHARLOTTE ZAHN SEWALL, DISTRICT 20

JERI B. GAUTSCHI, LEGISLATIVE ANALYST
SANDRA CHESLEY, COMMITTEE CLERK

HOUSE

JOSEPH C. BRANNIGAN, PORTLAND, CHAIR
HILDA C. MARTIN, VAN BUREN
ROBERT E. MURRAY, JR., BANGOR
PATRICIA M. STEVENS, BANGOR
JOHN A. ALIBERTI, LEWISTON
CHARLENE B. RYDELL, BRUNSWICK
JOHN TELOW, LEWISTON
RICHARD W. ARMSTRONG, WILTON
ALAN L. BAKER, ORRINGTON
GERALD A. HILLOCK, GORHAM

STATE OF MAINE
ONE HUNDRED AND TWELFTH LEGISLATURE
COMMITTEE ON BUSINESS AND COMMERCE

April 14, 1986

To: Rep. John N. Diamond, Chair, Legislative Council
From: Joint Standing Committee on Business & Commerce

Subj: Study Request

1. Committee or legislator

   Joint Standing Committee on Business and Commerce

2. Subject of Study

   Enabling the availability of credit through Finance Companies in the State

3. Priority number (for committee use)

   1

4. Completion date (next or subsequent session of the legislature)

   1st Regular Session of the 113th Legislature

5. Analysis of the problem

   According to current law (9-A MRSA, §2-308, sub-§3), if a loan is made at a rate greater than 18%, that loan must be repaid within 37 months or the rate drops to 8%. Additionally, if any other loans were made with the same lender after the original loan, those loans' rates drop to 8% as well at the end of the 37th month from the start of the first loan. The law was written this way in 1973 in order to prevent "flipping", rewriting loans to keep people continuously in debt. This section of Maine law eventually had the result of driving virtually all the finance companies out of the State.

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A bill was introduced in the 2nd Regular Session of the 112th Legislature to amend this law to allow negotiation by the parties of a maturity date and to allow refinancing of a loan at a similar rate. Passage of such a law would result in the return of finance companies to the State. A determination must be made whether this result is wanted or needed in the State.

6. Reason for study

The Committee decided more information was needed before passing a law which would encourage the return of finance companies to the State. The Bureau of Consumer Credit Protection has already begun an investigation into the topic, and has agreed to continue to gather information and complete the study. The Bureau will then report its findings to the Committee. Therefore, only one day is needed for the Committee to hear this report and make a decision.

The Bureau will survey the other 49 states to gather information concerning regulation of finance companies, complaints against finance companies, violations by finance companies, number of bankruptcies, and comparisons of credit unions and finance companies in meeting the needs of the people. The study will also focus on how well credit unions, credit cards, and banks are currently meeting the needs of the people of Maine.

7. Members of Subcommittee (for committee use)

The full committee needs to meet for one day only.

(After Deadline)
SECOND REGULAR SESSION

ONE HUNDRED AND TWELFTH LEGISLATURE

Legislative Document No. 2043

S.P. 811 In Senate, February 21, 1986

Approved for introduction by a majority of the Legislative Council pursuant to Joint Rule 27.

Reference to the Committee on Business and Commerce suggested and ordered printed.

JOY J. O'BRIEN, Secretary of the Senate

Presented by Senator McBreairty of Aroostook.

STATE OF MAINE

IN THE YEAR OF OUR LORD
NINETEEN HUNDRED AND EIGHTY-SIX

AN ACT to Enable the Availability of Credit through Finance Companies in the State.

Be it enacted by the People of the State of Maine as follows:

9-A MRSA §2-308, sub-§3, as enacted by PL 1973, c. 762, §1, is repealed and the following enacted in its place:

3. No consumer loan on which the annual percentage rate disclosed is greater than 18% may provide for a rate greater than 8% per year on the unpaid balances of the principal remaining unpaid at the expiration of 6 months after the scheduled maturity date of that loan. No loan may be deferred, renewed, refinanced or consolidated to circumvent or evade the provisions of this subsection. The administrator shall, by rule, identify those practices which constitute prima facie evidence of circumvention or evasion of this subsection.

STATEMENT OF FACT

The purpose of this bill is to remove from state law a nearly 20-year-old provision that was responsible for the elimination of finance company business from the State. That provision, the so-called "37-month rule," was enacted in the late 1960's in response to what was considered to be abusive practices by finance companies in keeping consumers continuously in debt to them through the practice of flipping. The 37-month rule provided that a loan with an interest rate greater than 18% must be paid out within 37 months of its original contract date or else the rate on it, and any other loans that the lender had with that consumer, would drop to a rate of 8%. This bill achieved its intended result: Within a few years, all finance companies had left the State.

Maine is unique in its dealing with finance companies. In no other state is there similar legislation the result of which has been to eliminate finance companies from among the financial service providers that exist within those states.

The approach taken in this bill is to strike a balance between the needs for strong consumer protections and the realities of the economic marketplace. There are certain areas of the State where the borrowing needs of consumers are not being satisfied and in which finance companies could return and provide helpful economic competition. This bill removes the impediment to their returning. At the same time it provides for protections against the practice of flipping by specifying that the Superintendent of Consumer Credit Protection adopt rules that will define the practice of flipping so that it is effectively prohibited.

5749021586

APPENDIX 3

Locations of Small Loan Offices
in Maine as of June, 1967. (109)

<u>Auburn</u>

Liberty Loan Corporation of Auburn

<u>Augusta</u>

Aetna Finance Company
Beneficial Finance Co. (Maine)
Commercial Credit Corporation
Liberty Loan Corporation of Augusta
Public Finance Corporation of Augusta
Seaboard Finance Co.

<u>Berwick</u>

United Finance Co.
Credithrift of America, Inc.

<u>Bangor</u>

Aetna Finance Company
Beacon Finance Company
Beneficial Finance Co. (Maine)
Commercial Credit Corporation
Household Finance Corp.
Public Finance Corporation of Bangor
Seaboard Finance Company
Time Finance Company
Universal C.I.T.

<u>Bath</u>

Beneficial Finance Co. (Maine)
Liberty Loan Corporation of Bath

<u>Belfast</u>

Coastal Acceptance Corp.
Public Finance Corporation of Belfast

<u>Biddeford</u>

Aetna Finance Company
Beneficial Finance Co. (Maine)
First Finance Co. of Maine
Public Finance Corporation of Biddeford

Brewer

Universal C.I.T.

Bridgton

Bridgton Finance Company

Brunswick

Beneficial Finance Co. (Maine)
Guardian Loan Co.
Public Finance Corporation of Brunswick

Caribou

Household Finance Co.
Liberty Loan Corporation of Caribou
Public Finance Corporation of Caribou

Farmington

Time Finance Corporation of Farmington

Gardiner

Beneficial Finance Co. (Maine)
Liberty Loan Corporation of Gardiner

Houlton

Liberty Loan Corporation of Houlton
Public Finance Corporation of Caribou

Kittery

#2 Credithrift of America
Kittery Finance Co.
Seaboard Finance Co.

Lewiston

Aetna Finance Co.
Beneficial Finance Co. (Maine)
Commercial Credit Corporation
Guardian Loan Co.
MAC Plan of N.E.
Public Finance Corporation of Lewiston
Time Finance Co.
Universal C.I.T.

Lincoln

Public Finance Corporation of Lincoln

Madawaska

Public Finance Corporation of Madawaska

Millinocket

Liberty Loan Corporation of Millinocket

Norway

Coastal Acceptance Co.
Norway Finance Co.

Ogunquit

Berwick Finance Co.

Old Town

Beneficial Finance Co. (Maine)
Liberty Loan Corporation of Old Town

Portland

Aetna Finance Co.
Auto Finance Co.
Auto Loan & Finance Co.
Avco Delta Credit Corp
Beneficial Finance Co. (Maine) 3 locations
Mitchell E. Burns
Commercial Credit Corporation
Guardian Loan Co.
Household Furniture Co.
Kane Finance Co.
M.A.C.
Mutual Finance Co.
Public Finance Corporation of Portland, 2 locations
Seaboard Finance
State Finance Co.
M.A. Sulkowitch
Time Finance Co.
Universal C.I.T.
Willco Finance Co.

Presque Isle

Commercial Credit Corporation
Liberty Loan Corporation of Presque Isle
Public Finance Corporation of Presque Isle
Universal C.I.T.

Rockland

Beneficial Finance Co. (Maine)
Liberty Loan Corporation of Rockland
Public Finance Corporation of Rockland

Rumford

Beneficial Finance Co. (Maine)
Public Finance Corporation of Rumford

Sanford

Beneficial Finance Co. (Maine)
MAC Plan, Inc.
Time Finance Co.

Skowhegan

Equitable Loan Co.
Franklin Financial Services
Liberty Loan Corporation of Skowhegan

South Portland

Beneficial Finance Co. (Maine)
First Finance Corp. of Maine, Inc.

Turner

Consumers Finance Corp.

Waterville

Aetna Finance Co.
Beneficial Finance Co. (Maine)
Commercial Credit Corporation
Liberty Loan Corporation of Waterville
Public Finance Corporation of Waterville
Seaboard Finance Co.
Time Finance Co.
Universal C.I.T.

Westbrook

Coastal Acceptance Co.
Public Finance Corporation of Westbrook

This list was compiled from the available records that were retained by the Banking Bureau and transferred to the Bureau of Consumer Credit Protection in 1975. There is a discrepancy of 7 between what these records reveal and what was reported in Professor Benston's study.

Appendix 4

HELEN T. GINDER, DIRECTOR
HAVEN WHITESIDE, ASST. DIRECTOR
GILBERT W. BREWER
DAVID C. ELLIOTT
GRO FLATEBO
MARTHA E. FREEMAN, SR. ATTY.
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MARGARET J. REINSCH
LARS H. RYDELL
JOHN R. SELSER
CAROLYN J. CHICK, PARALEGAL

September 15, 1986

To: Jeri Gautschi

From: Bob Dunn B.D.

Re: Summary of Dr. George J. Benston's, "Continuous High Interest Rate Borrowing and Consumer Welfare: An Analysis of Maine's "36 Month Limitation" on Finance Company Small Loans", 1974.

In 1967, the State of Maine passed a law that penalized finance companies by limiting the interest rate charged on the unpaid balance of a loan that was originally issued or extended for more than 36 months to 8 percent. This study examines the rationale behind such a law and the effect that it has had on finance companies and the lending industry in Maine.

Prior to its passage, this law was heavily debated. Much of this debate focused on a branch of microeconomics known as consumer choice theory. The debate questioned the validity of this theory. Without going into explicit detail, the major premise upon which consumer choice theory is based is that consumers have perfect information concerning products and prices and make rational purchasing decisions based upon this information. It is this premise, however, that fell prey to debate.

Those opposing the law believed that the borrowing decisions made by consumers are rational and that rather than creating a demand, finance companies were responding to the consumers' demand for credit. They contend that consumers borrowing at what seems to be an excessively high rate of interest does not constitute irrational behavior. The argument is offered that the interest rate charged is not excessively high, but simply an accurate reflection of the costs involved in lending relatively small amounts to a relatively high risk group of consumers.

Some in favor of the law contended that consumers do not make rational borrowing decisions or that consumers are enticed into high rate borrowing by finance companies. Not realizing the amount of income that is required to meet the interest and principal payments, the consumer soon finds himself in a position of long term indebtedness to a high interest lender. Further criticism of consumer choice theory, by others in favor of the "36 Month Limitation," was the questionable validity of the assumption that consumers have perfect information regarding products and prices. Those backing the law felt that given the available information, consumers were behaving rationally. Consumers were simply unaware of lower rates at which they could borrow form commercial banks and credit unions.

Those in favor of the "36 Month Limitation" cite other reasons, outside the bounds of consumer choice theory, as to the need for such a law in the State of Maine. For instance, Maine State Senator Peter Mills, the leading proponent for the "36 Month Limitation" contends that the differences between finance companies and banks are so great that legislation which serves to regulate these companies is warranted.

> "They are not like banks. They are not doing banking business. They are not in there providing a service to people who need money in trouble. They are pandering these loans. They are pushing these loans onto people who shouldn't have them."
> Journal, Maine State Senate, June 8, 1967, debate on Senate Amendment "A" to bill "An Act Revising Laws Relating to Licensed Small Loan Agencies" (H.P. 468) (L.D. 681).

Proponents of this legislation also cited the number of personal bankruptcies in the State of Maine as another reason why the "36 Month Limitation" would be beneficial. Long term indebtedness, a common characteristic of finance company customers, was believed to be one of the prime causal factors of bankruptcy.

With the passage of the "36 Month Limitation" law came a drastic decline in the number of finance companies and offices operating in Maine. This decline is explained with an analysis of finance companies operations and costs.

A finance company's decision to lend to a potential customer is based upon the perceived profitability of the loan. The costs involved in lending to new borrowers are greater than lending to present or former borrowers. These costs manifest themselves primarily in the form of information costs. Long term lending relationships, that is lending to present or former customers, tend to be advantageous for the lender in that a reduction in losses may be realized by permitting a borrower to extend payments It is also common to find long term borrowers having larger outstanding balances than new borrowers. Upon implementation of this law, lenders no longer have the luxury of extending the term of a loan.

The operating costs of a finance company are a function primarily of the number of loans serviced rather than the amount the loan is serviced for. Potential customers are perceived as profitable only if the companies can expect to service additional loans or renew existing ones for them in the future. This expectation no longer exists with the "36 Month Limitation" in effect.

An analysis of lending data from the period 1960 to 1971 proved consistent with these explanations. Prior to the enactment of the "36 Month Limitation" in 1967, the loss rate in Maine averaged 2.2 percent.[1] This figure had risen to 4.10 percent in 1969. The average cost per loan in the early 1960's was computed to be $56, rising to greater than $105 in Calculation of the companies' rate of return on assets showed that finance companies were not in a position to absorb the impact of the "36 Month Limitation." Thus, the effect of the "36 Month Limitation" along with the reduction in the ceiling rate resulted in a decline in the profitability of finance companies causing them to reduce and eventually cease operations in Maine.

In aggregate terms, the reduction in finance company lending seems to have resulted in a lower amount of loan dollars supplied relative to the amounts demanded. The aggregate data, however, are not adequate to determine whether consumers who would have otherwise borrowed at finance companies were served by other lenders. In an effort to determine this, a representative group of these individuals was surveyed.

After the imposition of the "36 Month Limitation," half of the four hundred sixty people surveyed were unable to obtain funds elsewhere. Characteristics such as occupation, salary, age, marital status, number of dependents, percent of loan unpaid at the time, and years in debt and previous loans to the finance company did not differ statistically between those who could and could not otherwise obtain funds. The reason for borrowing, however, did differ statistically. The purposes of consolidating debt or purchasing a new car characterized a higher percentage of those who were able to obtain funds elsewhere. Relatively more of those who could not obtain funds wanted money for the purpose of purchasing furniture and household items. However, the percentages of each group that were seeking to borrow for what might be termed "socially acceptable" purposes,-- to pay school expenses, pay medical

1. The loss rate of a finance company is equal to the percentage of loans that are defaulted on.1971.

bills, and make home improvements-- were in essence the same for each group. There seems to be no evidence that suggests that those unable to obtain funds wanted the money for "less worthy" purposes.

In testing the belief that long term indebtedness results in bankruptcy, it was found that the majority of consumers declaring bankruptcy were relatively new customers of the company. Thus, contrary to the proponents' belief that long term indebtedness is positively related to bankruptcy, it is unlikely that this is a causal factor

The "36 Month Limitation," regardless of its intended purpose, appears to have been a prime factor resulting in most finance companies leaving Maine. Along with the "36 Month Limitation" which makes long term lender-borrower relationships infeasible, a state imposed ceiling rate, appears to have made small loans unprofitable. The end result is that loans of less than $100 are not often made and consumers wanting to borrow such small amounts are not made. The results of this study show that half of the consumers surveyed who previously were considered good customers could no longer obtain funds. The theoretical consequence of a situation such as this, one in which demand exceeds supply, is the evolution of black markets.

RWD-6883M

Appendix 5

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JOHN R. SELSER
CAROLYN J. CHICK, PARALEGAL

October 21, 1986

To: Jeri Gautschi

From: Bob Dunn BD

Re: Summary of George J. Benston's, "The Impact of Maturity Regulation On High Interest Rate Lenders and Borrowers", 1976.

<u>Conclusions</u>

In this article concerning Maine's "36 Month Limitation," Dr. Benston empirically tests hypotheses put forth by both proponents and opponents of the legislation. In summary, the most significant of these hypotheses include;

1) Proponents suggested that finance companies were making abnormal and immoral returns before the penalty on maturities over 35 months was imposed, and now they are not satisfied with normal profits. Empirically, this hypothesis was found to be false.

2) Proponents also felt that abnormal, immoral revenue was generated by tempting consumers into making improvident loans which they couldn't repay and had to renew. This too was found to be false when tested empirically.

3) Consumers were benefited rather than hurt by the imposition of this legislation because they were able to obtain loans at credit unions and other lower rate lenders is another of the proponents' hypotheses. Opponents of the legislation argue the direct opposite, however. Consumers are worse off when an important source of credit is no longer available. The available data supported the opponents' hypothesis. Only half of those who wanted to borrow and to whom the finance companies would have loaned obtained the desired funds.

4) Opponents also felt that since extensions of loans to borrowers in default is very costly when the balance earns only 8 percent, companies are forced to attempt to collect these loans rather than "work with" the customer. This hypothesis was proven to be true when tested empirically.

The conclusion of this analysis is that legislation that restricts the term of finance company loans to consumers drives these lenders out of the market and hence limits the availability of funds to consumers. It is Dr. Benston's opinion that this limitation appears unjustified and unfair to consumers who would prefer the services offered by finance companies or who have no other legal alternative.

<u>Discussion</u>

This study examines the impact that the imposition of Maine's "36 Month Limitation" has had on the number of finance company offices in the State. This regulation, imposed in 1967, effectively restricted the maturity of high interest rate loans to 36 months. Within ten years, the number of finance company offices located in Maine had fallen from 116 to 0. All but 24 of the initial 116 offices had ceased operations within five years of the imposition of this regulation. Hypotheses on the effect and value to consumers of the regulation are stated operationally and tested empirically.

Those in favor of this regulation believe that many consumer finance companies keep their clients in debt continually. Advocates point out that of the three variables rate, time, and amount which determine the consumer's cost of borrowing, most regulation has focused on controlling only the rate of interest by setting maximum statutory limits. This regulation, however, controls the term for which a specific rate can be charged.

Proponents of the law felt that finance companies had been making exorbitant and immoral profits. Their departure was viewed as proof that they were not satisfied with normal profits. As the advocates see it, the "36 Month Limitation" reduces the finance companies' revenues by preventing them from 'exploiting ' the consumer.

A somewhat different explanation for the decline in the number of finance companies is that the companies were initially operating on the downward sloping portion of their long-run average total cost curve. By closing some of their offices and consolidating their operations into fewer, larger offices, companies were able to expand operations on their long-run average total cost curve to a point that enabled them to achieve economies of scale.

In any event, consumer advocates believed that consumers were not seriously inconvenienced by the decline in finance company lending.

Opponents of the legislation refute the contention that finance companies should be able to make normally profitable one-time loans with maturities of less than 36 months. They claim that operating expenses are higher under such restrictions. The costs of obtaining information are less when dealing with a present customer. Risk is also reduced in lending to a present customer because the payment record is known.

Those opposing the legislation contend that the costs of obtaining information are less when dealing with a present customer. Risk is also reduced in lending to a present customer because the payment record is known.

Those opposing the legislation also contend that the 8 percent maximum rate on balances outstanding more than 36 months decreases the lending companies average gross yields intolerably. The end result is that consumers are not able to locate another source to borrow from.

When tested empirically, the hypothesis regarding the lower average gross yields showed that although lower average gross yields might explain a reduction in the number and riskiness of loans made, it does not appear to be the primary reason behind the downfall of the industry in Maine.

Empirical analysis of finance company operations shows that the cost of processing loans makes those under about $300 to $400 unprofitable. Since first time borrowers tend to borrow such small amounts, the companies count on the larger, profitable loans taken when customers renew or add to their initial loans. Finance companies also rely on loan extensions to allow a borrower to pay out his debt. These factors explain why finance companies cannot operate profitably with the "36 Month Limitation" in force.

Through the use of multiple regression analysis, it was shown that the coefficients estimated contradict the hypothesis that consumer finance companies reduced the number of offices to achieve economies of scale. The geometric mean number of loans per office decreased from 367 in 1960 to 269 in 1970.

The hypothesis that the costs of lending to new customers are greater than for a present or former customer was tested in a previous study by Benston (1974a). In that study, it was found that a law restricting lending to new customers would increase operating costs sufficiently to 'explain' the demise of the small loan companies in Maine.

Another opponents' hypothesis tested by Benston was that since extensions of loans to borrowers in default is very costly when the balance earns only 8 percent gross interest, companies are forced to attempt to collect these loans rather than 'work with' the customer. The analysis conducted supports this hypothesis. It appears that the impossibility of extending loans and the impossibility of maintaining a long-term customer relationship were important factors in the decision of finance companies to cease operations in Maine.

The net income before income tax and interest expense of most finance companies in Maine in 1969 (when the 1967 law began to take effect) was found to be inadequate to support continued operations. This refutes the proponents' hypothesis that finance companies left Maine because they were not satisfied with normal profits. It appears that the rapid exodus of finance companies from the state was a result of the decreasing returns due primarily to the "36 Month Limitation."

Benston also empirically analyzed the effect of the decrease in finance companies' lending on the availability of credit to consumers. This analysis suggests that other lenders did not completely replace the loans that would have been made by finance companies. In specific, half of the former 'good' finance company customers included in this analysis did not obtain the funds they wanted and 40 percent of those who did obtain funds got them from another finance company.

The final area of investigation included in this study is an examination of the characteristics of long and short term borrowers and their respective relationships with bankruptcy. The occupations, salaries, marital status, number of dependents, and stated reasons for borrowing show that customers of finance companies are a diverse group. Age was found to be the only variable that was related to previous indebtedness. The available data also showed that persons declaring bankruptcy had renewed their loans far less often than those who were considered good customers by the finance company. This is contrary to the belief that long-term indebtedness is a causal factor of bankruptcy.

References

Benston, G.J., 1974a, The costs to consumer finance companies of extending consumer credit, in National Commission on Consumer Finance, Technical studies II (U.S. Government Printing Office, Washington, DC) 1-158.

The Consumer Credit and Sales Legal Practice Series

Consumer Usury and Credit Overcharges

Written by Mark H. Leymaster, Esq.

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Ledger cards can reveal such a pattern, which might support a systematic usury claim against the lender.

Third, interval adjustment rules may be abused by contracting for irregular payment intervals. Special allocation rules may be required for calculating interest on irregular intervals, and irregular intervals may lead to peculiar results when rebate formulae are applied.

Perhaps the most common abuse is the irregular first period transaction with an unusually long initial period.[114] A rounding assumption may be used to exaggerate the lender benefit. For example, lenders frequently treat an initial 45 day first period as the equivalent of 1 and 1/2 or even 2 intervals for rebate purposes. This creates incongruous results under the rule of 78's and is rarely justifiable under the statutory formula. Conceptually, there can be no half intervals under the Rule of 78's. The interval must be rounded but it should never be assumed that rounding up is legal.

One key to attacking these practices is searching for lender inconsistency. Self-serving overchanges are obvious when the mathematical procedure is inconsistent. Rounding the numerator up for an irregular interval but rounding the denominator down is one example. This inconsistency further distorts the rebate fraction in the lender's favor.

6.8 REFINANCING AND NEW ADVANCES ON EXISTING CONSUMER CREDIT

Old loans can be renewed or converted into new loan, in several ways: by refinancing, by flipping, or by consolidating. All three increase lender income at the borrowers expense. *Refinancing* refers to renewing a credit contract with the original lender by another contract of essentially similar type and cost. *Flipping* is the more profitable practice of renewing a low cost consumer debt, such as a credit sale, by converting it to a high rate personal loan. *Consolidation* involves aspects of both refinancing and flipping.

6.8.1 REFINANCING

Refinancing is the most frequent form of prepayment: upwards of two thirds of all finance company loans are refinanced each year.[115] Refinancings are technically voluntary, but borrowers rarely appreciate the consequences of refinancing.

Most refinancing is a result of aggressive solicitation by a lender who presses a current borrower into borrowing an additional amount. After repeated solicitations, the borrower may succumb to the temptation and borrow a little more on the mistaken assumption that the additional expense will be small. Most borrowers do not realize that instead of acquiring a small second loan, the earlier debt is combined with the new advance to create a new balance. Part of the new principal is used to prepay the first loan. Some borrowers refinance several times.

This type of borrowing substantially raises the effective cost of credit to the customer even when the prepayment and rebate calculations are performed correctly. Given additional abuses that usually accompany refinancing, the cost of the small additional advance may be surprisingly high or usurious.

Borrowers are more apt to succumb to lender pressure if their economic situation has suffered. Refinancing appears to be a solution to loan delinquencies and defaults. Borrowers can be pursuaded to refinance by half-truths that a borrower can erase any late payments or arrearages on the old loan by refinancing it.

Borrowers occasionally approach lenders with requests for additional funds. The extension of additional credit in this situation also leads to refinancing. The borrower may believe that the additional cash advanced is a new, smaller loan or an increase on the old debt, but the lender refinances the entire indebtedness into a fresh debt with new interest charges, credit insurance premiums, and other fees.

The lender receives many benefits from refinancing. The lender collects the entire unpaid principal and earned interest from the old loan, plus late charges, deferral fees, and other hidden penalties. Refinancing includes any bonuses derived from lender oriented rebate calculations on the old loan and the benefits of contracting for new interest rates and new credit insurance premiums on a larger principal balance. If the usury rate ceiling has increased, the new loan bears a higher interest rate. The bulk of the new principal is not advanced, but is paid to the lender to retire the old balance. The lender receives the penalties and charges levied, regardless of whether they were legal or collectable.

Although lenders benefit greatly from these renewals, the refinancing borrower is rarely aware of the costs involved or the advantages to the lender. The lender's benefits are so great that they outweigh the apparent absurdity of increasing the borrower's debt at a time when the recent repayment experience suggests that the new larger debt might be unmanageable for the borrower.

Many borrowers refinance again, often within months of a previous refinancing. This is such a central characteristic of high cost consumer lending that finance companies will not operate if refinancing is limited. This repeated refinancing makes fixed term loans similar to revolving credit.[116]

6.8.1.1 Refinance Calculations in Action

Refinancing is best understood by showing an example of lender practices in refinancing. Consider an 8% add-on note for $4,000 that will be repaid in 72 regular monthly installments of $82.22. Interest is precomputed. The total of repayments is $5920. The lender income of $1920 includes a

114 *See* § 4.5 supra (demonstration of bonus for prolongation).

115 *See* note 20, *supra.*

116 Finance companies have a policy of keeping their loans at the limit that the borrower can tolerate. This strategy is implemented by refinancing; 2/3 to 3/4 of the new lending by finance companies is refinancing. There are several reasons for this: refinancing and prepayments are independently profitable, lending to existing borrowers is less risky because the company knows their habits and capabilities, and it is cheaper to determine the qualifications of refinancers than of new borrowers. In addition, larger loans marginally reduce administration and regular refinancing stabilizes the company's portfolio. For the most part, finance companies do not originate debt: they collect loans of others by refinancing and debt consolidation.

nonrebatable 2% service charge of $80. Assume that the contract includes credit life insurance premiums of 65¢ per $100 or $38.48 per year, for a total of $230.88. Assume the only other fixed fee is a $5 filing fee; but if an installment is late, the lender can charge a $4 late fee.

Assume further that the borrower has gotten into financial trouble only in the last three months, resulting in two payments that were nearly late, but reached the creditor before the end of the contract grace period. Refinancing occurs a few days after the due date for the 24th payment. Although there is nothing illegal at this point, the lender calls the borrower, suggests that the loan is in trouble,[117] and offers to "help." Touched by the apparent concern by the lender, and needing $200 to pay a fuel bill, the borrower comes to the lender's office and ends up taking an additional cash advance.

To appreciate what refinancing actually costs the borrower, the costs of refinancing should be compared to the costs of the transaction the borrower probably believes is happening: borrowing the $200 separately on the same terms as the original note.

If the $200 was borrowed pursuant to a one year installment loan, the financed amount, including credit life insurance would be at least $201.30. A loan of this size would not require any collateral, so there would be no filing fees as in the earlier loan. At 8% per annum add-on, the precomputed finance charge levied would be $16.10, of which $4.02 would be the nonrebatable 2% service charge.[118] The transaction has an annual percentage rate of 14.45% and would require 12 monthly payments of $18.12. Therefore, the borrower would pay $17.40 (interest and credit insurance) for the additional $200.

If the borrower could persuade the lender to match this transaction with the remaining four years on the original note, the loan of $200 would have 48 payments. This would require at least $5.20 in credit life insurance premiums and $65.66 in interest, totaling $70.86 for interest and credit insurance to borrow the $200.[119] The payments would be $5.64 per month at a 14.35% annual percentage rate, for a total of payments of $270.86.

These costs should be added to the costs for the remaining four years on the original transaction that will not be refinanced. Because the lender uses precomputation, the 23 payments already made (23 × 82.22 = $1891.06) are simply subtracted from the total amount originally due: $5920 − $1891.06 = $4028.94 yet to be repaid. Thus, if the two notes were independent but coordinated, the borrower would have to pay $4299.80 ($4028.94 + 270.86 = $4299.80) over the next 4 years.

What actually happens is significantly different. The prepayment calculations for refinancing that will be used are typical of a lender using self-serving assumptions.

The lender first calculates the prepayment balance on the old transaction, using the Rule of 78's for interest and credit insurance. This assumes that the state special usury authorities are ambiguous. Because refinancing occurs a few days into the 25th interval, the lender assumes there are only 47 intervals remaining. Using the sum of the digits formula, the rebate factor is (47 × 48)/(72 × 73) = 42.9%. Because of the nonrebatable $80 service charge, the rebatable portion of the precomputed interest is only $1840 ($1920 − $80 = $1840). The borrower receives a rebate of $789.36 for unearned interest ($1840 × 42.97 = $789.36). Actuarially, the lender has only earned $987.69 through the 24th month, compared to the $1130.64, including the $80 service charge, which is based on the Rule of 78's. By using the rule, the lender receives an interest bonus of $142.95.[120]

A similar rebate bonus occurs with the credit insurance premium. Applying the same rebate factor (42.9%) to the overall premium of $230.88, the borrower receives a rebate of $99.05. If the premium is earned actuarially, the typical method used by third party insurors, then only 51.4% of that premium has been earned through the 24th interval: $118.67 rather than the $131.83 awarded under the Rule of 78's. Adding the insurance bonus of $13.16 to the interest bonus, the lender receives an extra $156.11 from the original contract solely because of the rebate mathematics.

This is not the end of the self-serving process of refinancing. Other adjustments must be taken to arrive at the prepayment balance. The financed amount for the refinancing must be calculated and the additional fees, insurance premiums, and interest must be included.

Three steps are required to determine the prepayment balance. First, the lender evaluates the transaction to determine whether there are any additional fees or penalties that can be claimed on the account. In this situation, the lender will probably decide that one or possibly three late charges are owed. If the refinancing disbursements are not made on the old account until the following day, the last payment will technically be late, justifying the imposition of a $4.00 late charge. The lender will probably include an additional $8.00 charge for the 22nd and the 23rd payments, though they are within the contract grace period because the lender knows that the consumer will probably not recognize the charges and is unlikely to dispute them. Consequently, the prepayment balance will include $12.00 in late charges and $4028.94 of unpaid payments, less the rebate credits of $789.36 for interest and $99.05 for credit insurance. Therefore, the prepayment balance computed by the creditor is $3152.53.[121]

The second step in the refinancing is to calculate the new financed amount by adding the $200 cash advance, the new filing fees, and the new insurance premiums. To permit direct comparisons, assume that the lender plans the new transaction to run only for the remaining four years (which is extremely unlikely in practice). This will result in a monthly payment significantly larger than that on the original note, with a result that few borrowers will be able to accept such terms. (Typically, the note would be refinanced

117 Usually this vague threat follows a solicitation for additional easy borrowing. Solicitation is usually accompanied by a statement that the borrower still has good credit.

118 This service charge is part of the statutory interest. In many states such a service charge is not included in interest, and, thus, would be added to the other credit costs.

119 The applicable special usury statute may not permit this long repayment period on such a small amount.

120 $1130.64 − $987.69 = $142.95.

121 If the borrower had initially contracted for a 24 payment transaction with $4000 as stated principal, requiring a final balloon payment of $3152.53, the annual percentage rate on the loan would have been substantially greater than the 13.91% annual percentage rate of the original transaction.

for another 6 years, which further exaggerates the additional cost of the transaction.) When the new credit life insurance premium of $119.14[122] is included, the new financed amount is $3471.67[123] at the same 8% per year add-on; this would cost $1110.93[124] in finance charges, to be repaid at the rate of $95.47[125] per month. As before, the credit life insures the total amount repayable.

In comparison with the transaction the borrower expects, the fact of refinancing is costing him or her $282.80[126] *more* than it should, when the rebate penalties are included. And this is the minimum refinancing bonus.

No lender, however, would prepare such a transaction. The new monthly payment is higher than that on the old account. To reduce the size of the new payment the term of the refinanced transaction would be longer.

The new note would be written for 6 years and the monthly payment would be $73.13.[127] This transaction actually costs $5265.68 or some $965.88[128] more than the 4 year loan transaction just discussed. This is some $1019.34 more if the extra $200 were than only borrowed for one year and no refinancing occurred.[129]

In reconstructing refinanced calculations, more steps are usually required than the four used here because there are typically two or even three credit insurance policies involved, which may have to be evaluated separately. Often the lender also claims more fees and charges than used in this example, requiring separate investigation. In addition, the lender's determination that late fees are due may not be correct. Late charges should also be recalculated, if they are based on a formula, because lenders occasionally use self-serving assumptions. The actual earning pattern of the loan may be complicated by skipped payments and other irregularities.[130] Unless an actuarial rebate is required, it may not be necessary to precisely reconstruct the amortization of the loan as it was actually repaid. Finally, it is usually vital to evaluate insurance premium rebates on interest bearing or revolving accounts, which are frequently overlooked.

6.8.2 FLIPPING AND LOAN CONSOLIDATION DISTINGUISHED

Flipping, another kind of consumer credit renewal, is more expensive than refinancing. *Flipping* converts a low interest rate debt into a higher rate debt. In this manual flipping is distinct from refinancing, although the term refinancing is often used to describe both kinds of lender activity by members of the credit industry and in statutes.[131]

Flipping is subject to the same abuses as refinancing. Flipping, like refinancing, involves three injuries:

- Paying substantially more than necessary for the transaction;
- Remaining obligated for a longer period of time than originally obligated; and
- Entering a transaction that would have been avoided had the borrower realized the true cost.

Flipping entails the additional injury of higher interest rates. A typical flipped contract is a retail credit sale converted into a direct loan with a substantially higher interest rate. Finance companies often buy retail installment sales contracts by assignment in order to flip them.

Three other features of flipping add to the unfairness. First, the lender typically adds nonpurchase money collateral security. Such collateral is often unavailable in the credit sales situation and should be unnecessary in the new transaction. Second, because the retail installment sales contract is purchased at a discount, the full principal value of the contract is not advanced to the assignor. Third, conversion to a direct loan often allows the imposition of additional fees and charges illegal under the credit sales usury law.

Consolidation of several debts into one finance company loan or second mortgage may involve multiple flipping or refinancing. Usually, consolidation converts a group of short term, low interest loans into a single long term transaction at a high interest rate.[132]

High rate lenders rarely originate new credit. They operate largely as debt collection entities, charging high rates in return for arranging longer repayment periods for

122 Credit insurance is written on the total amount repayable at 65¢ per $100 per year. On loans at 8% add-on for four years, the total amount repayable is 1 + 8% × 4, or 1.32 times the financed amount. Because the insurance premium is included in principal, the total amount repayable, per dollar of principal, excluding the insurance premium is: (1 + F)/(1 − P × (1 + F)); F = the financing rate, overall, and P = the insurance premium rate, overall.
For a four year loan, the premium rate is: 4 × $.65/$100 or .026, so the total amount repayable per dollar is: (1.32)/(1 − .026 × 1.32) = 1.3669.
In order to finance the new advance of $200 + $3152.53, the prepayment on the prior loan, the total amount repayable is 1.3669 × $3352.53, or 4582.60, so the insurance premium would be: 4582.60 × .026 = 119.14.
See note 118, *supra* (2% service charge is not computed separately and operates to render part of the add-on interest unrebatable but does not increase costs); *see e.g.*, § 7.3 *infra* (in many states the charge is extra).

123 $3152.53 + $200 + $119.14 = $3471.67.

124 $3471.67 × 8% × 4 = $1110.93.

125 ($3471.67 + $1110.93)/48 = $95.47.

126 The borrower will repay $4582.60 as compared to the expected $4299.80. $4582.60 − $4299.80 = $282.80.

127 Using the formula at note 122 *supra*, the six year financing rate is: 6 × 8% = .48 and the credit life insurance rate is: × 6/$100 = .039, so the total amount repayable per principal dollar (net of insurance premiums) is: 1.48/[1 − (.039 × 1.48)] = 1.57066. Refinancing the total amount repayable is $(3152.53 + 200) × 1.57066 or $5265.67. In 72 payments (6 years) that is $73.13 per month ($5265.68/72).

128 *See* note 127 *supra* ($5265.68 − 4299.80 = 965.88).

129 *See* note 118 *supra* ($200 loan costs 217.40, including credit isurance). The old remaining debt will cost $4028.94 unrefinanced, for a total of $4246.34. Compared to the six year refinancing, the difference is $5265.68 − $4246.34 = $1019.34.

130 *See* 7.3 *infra*. In precomputed bookkeeping, the irregularities usually generate extra fees (late charges, deferral charges) that must be included in the calculations. In interest bearing bookkeeping the interest effects also must be carefully checked by working out the amortization.

131 The terms renewal, refinancing, and flipping are used in different ways by the credit industry and in different statutes.

132 This opportunity is central to consumer finance because many loan companies could not exist in their present form if they were unable to flip consumer paper. This may be what California law has been interpreted to forbid. *See* cited note 135.

borrowers and quick payoff of other creditors who originated the consumer's debt.[133]

The following is an example of *flipping*. Assume that a $1000, 3 year transaction at 18% is flipped into a direct loan at 36% simple interest after 12 payments have been made on the old retail installment sales note. The old note is prepaid, with adjustments because of differences between the two types of credit.

Under the Rule of 78's, 41.4% of the interest is due to be rebated, which would amount to $124.94.[134] If credit insurance was written on the retail note at 65¢ per $100, then $10.50 would be returned from the $25.37 originally charged assuming that the assignee bothered to rebate any credit insurance at all and that the Rule of 78's was used for the rebate.[135] Of the $867.65 remaining as the unpaid total amount on the precomputed note,[136] there will be $732.21 required for prepayment after the rebates are credited.[137]

Assume that no new cash was advanced as a result of the flip and that no additional time was given for repayment.[138] Coverting this transaction to a 36% annual percentage rate, 2-year note is bad enough, but additional amounts are added into the financed amount. Certainly, credit life insurance will be used in the new loan costing $21.35,[139] at $1 per $100 per year.[140] To the extent the lender has other kinds of credit insurance available, the borrower may be persuaded to purchase credit disability insurance and credit property insurance on the original goods financed. The borrower may also purchase insurance. Assuming that the additional insurance results in an additional $75.00 charge, the costs increase further. Because the lender requires collateral, a filing fee or two is charged, perhaps amounting to $4.00. If the direct lending special usury law allows other fees and charges for services, the borrower is also going to be charged those fees[141]

The total financed amount is thus $830.74.[142] This is amortized at a 36% annual percentage rate, resulting in an obligation to pay $49.05 per month for the remaining 2 years, for a total of $1177.25.[143] The borrower is going to pay $309.60[144] more because of the flip and receive nothing in return. If this $1000 contract was originally purchased by the finance company at a 15% merchant discount, then the yield on the $850 investment is more than 40%.

Flipping a loan increases the credit costs more than refinancing does. In the refinancing example,[145] the credit cost jumped 107%.[146] By contrast, the flipping increases the cost of credit 216%![147]

The extent to which the additional interest cost hurts borrowers should not be underestimated. The example given here presumes expensive retail credit at the beginning. In many flipping situations, the original credit is at lower interest rates. When low interest credits are flipped into 24%[148] or 36% transactions, the increase in effective cost for the same credit is astronomical.

Along with paying substantially more interest, borrowers are typically exposed to more severe contractual provisions in direct lending than in retail installment sales credit. Differences include stiffer late charges, more expensive deferrals, and other fees and charges. In some situations, retail installment notes may not provide for prepayment penalties or for forfeitures in the event of default, though they may be included in the new direct loan contracts.

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133 *See* note 20 *supra* (industry bench marks show that from 65-70% of all new loans are made to present borrowers).

134 The total interest charge is $301.48 by amortization. In many states a prepayment after the 12th payment and before the 13th is evaluated as if executed on the 13th payment date. The usury statute may provide interval counting rules or there may be local regulations. *See* note 135 *supra*. As of the 13th payment day, 36 − 13 = 23 payments remain, under the formula: R × (R + 1)/T × (T + 1). R is the remaining number of intervals and T is the total number, then:

$$23 \times 24/36 \times 37 = .4144,$$
and
$$\$301.49 \times .4144 = \$124.94.$$

135 *See* Vasquez v. Schwoeble, No. NCC 11933B (Cal. Super. Ct. 1981) (flipping usurious where the finance company never rebated credit insurance).

136 This is a precomputed but actuarial loan. Charts may have been used to create its terms, but the lender is bookkeeping with precomputed methods. Thus there remains an unpaid balance that includes unearned interest. There would be unearned insurance premium amounts even if this were an interest bearing account.

137 $867.65 − (rebate) $124.94 − (insurance premium rebate) $10.50 = $732.21.

138 These are atypical, but makes the example easier to follow and the comparison more direct.

139 *See* note 122 *supra*. A two year loan at 36% simple involves $41.71 in interest per $100 borrowed, or .4171, and two years of insurance at 1% per year means the total amount repayable per dollars net of insurance cost is: 1.4171/[(1 − (.02 × 1.4171)] = 1.45843 on a flip of $732.21 the total amount repayable is $1067.87. At 1% per year, the insurance premium is: 1067.87 × .02 = $21.35.

140 This is an increase over the 65¢ rate on the credit sale to show the effect of higher premiums. These occur because loan companies are more prone to charge the maximum legal rate for insurance than credit sellers.

141 *See* note 135, *supra*.

142 That is $732.21 + $75.00 (other insurance) and $23.53 for credit life insurance. Adding the additional $75.00 has increased the total repayable and thus raised the credit life insurance proportionally. Using the factor in note 139 *supra*, the extra $75.00 increases the total repayable by: $75.00 × 1.45847 = $109.38, of which 2% or $2.18 is extra credit life insurance $2.18 + 21.35 = 23.53.

143 *See* notes 139, 142, *supra;* 1067.87 + $109.38 = $1177.25.

144 1177.25 − 867.65 (the old debt) = $309.60.

145 *See* 6.8.1 *supra*.

146 Convert the costs at note 129 *supra* into interest net of unpaid principal. If the old loan is left unpaid, $4028.94 − 3096.60 (the actuarial unpaid principal) = $932.34 of interest remains. In combination with the one year new loan of $200, the borrower thinks (s)he might pay $(932.31 + 17.20) when in fact it costs $1019.34 more:

$$(1019.34 + 932.34 + 17.20)/$$
$$(932.34 + 17.20) = 207.4\%,$$

an increase of +107.4%.

147 In the flip the credit costs increase $309.62. By amortization, $724.15 of principal is outstanding after 12 payments, so $143.41 (867.56 − $724.15 = $143.41) is future interest. Thus the interest costs have increased: ($309.62 + 143.41)/$143.41 = 315.8% or an increase of +215.8%.

148 Although it depends on the lender, flips usually do not go as high as 36%. In many states, such as those without rate ceilings, there is no economic or legal reason not to charge whatever the market can bear.

Finally, the collection remedies, such as attorneys' fees and postacceleration interest rates, are usually contracted at the legal maximums.

Flipping hides usurious credit. Like refinancing, the flip causes the earlier illegal contract to apparently disappear from the lender's records. The lender can now enforce payment on the transaction through the newer contract.[149] Flipping also simplifies contract irregularities, that hide unscrupulous practices.

A third surprise in flipping is the introduction of collateral and creditor security requirements not used in the credit sale. Few direct loans are written without nonpurchase money collateral. Second mortgages on residences are created when flipping is accomplished through consolidation equity loans.[150] Intangible securities such as cosignatures and wage assignments may also be taken in conjunction with flipping; confession of judgment clauses, where legal, may also be added. This creates surprises and consumer injuries if the borrower still thinks of the debt as a credit purchase. Borrowers refuse to continue making payments on such credit sales if there are severe product quality problems or breaches of warranty. The unfortunate effect of such a refusal is that the resulting default can lead to the repossession of the individual's car, the taking of a wage assignment, or other creditor remedies. This may also be the first occasion to discover how much money is actually owed.

6.8.3 CONSOLIDATION LOANS: REFINANCING AND FLIPPING COMBINED

Creditors like consolidation loans because they combine the "best" features of refinancing and flipping. Such a multiple prepayment is complex, poorly understood, and unlikely to be disputed.

Consolidation lending is growing because nondepository lenders have discovered nonpurchase money residential security. These are typically thought of as second mortgages, though many lower income clients may give nonpurchase money first mortgages.

The most improvident lending[151] may be in second mortgages because the lender is actually speculating in real estate. High rate loans secured by homes require large repayments even at moderate interest rates. If the loan fails, the creditor assumes ownership in residential real estate. Because the profit potential is high, little responsibility is shown by lenders concerning alternatives to equity financing and the borrower's reasonable ability to repay. Borrowers are sometimes deceived and sometimes oblivious to the risks that they have to continue payments or lose their home.

Whether or not consolidation loans involving real estate collateral are covered by special usury laws varies from state to state. In a few jurisdictions, second mortgage usury laws apply if there is already a purchase money mortgage on the residence. In most other jurisdictions, second mortgage lending limitations are in the specific usury laws, such as the small loan or consumer finance law. These usury laws may prohibit:

- Loans requiring balloon payments, other irregular sized payments, or non-self-liquidating, second mortgages;[152]
- Compounding or charging interest on amounts not included in principal at the time of loan consummation;[153]
- Extra fees beyond those specifically allowed, thus prohibiting separate charges for closing costs, appraisals, or title searches;[154] and
- Additions to principal, other than those explicitly allowed, that might preclude financing of certain costs because the special usury law never contemplated realty security.

Most states also have a large number of rules limiting conveyancing, such as prohibitions on real estate closings that are not at legally approved places; thus, real estate titles taken in a loan office may be unenforceable. The strongest usury protection, however, is prohibiting real estate security. A loan using prohibited collateral usually loses its statutory exemption from the general usury law.

6.8.4 EVALUATING PREPAYMENTS AND RENEWALS

In calculating prepayment and refinancing follow the same steps the lenders would use. Although the contract and usury law control, the four steps discussed in section 6.7 are typical.

The temptation for abuse and the detail in renewals increase the likelihood of usury and illegality.[155] The calculations can be tedious and sometimes complicated but they are worthwhile. Even if no usury develops, patterns and practices of charging or contract interpretation that may be legally vulnerable may be found. Any number of matters, such as deception, false consideration, and even breach of contract may appear. These failings might void the underlying contract, excuse or discharge performance by the borrower, or raise equitable defenses.

Each separate refinancing in the chain should be calculated and checked. The more steps that must be taken, the likelihood of errors increases. Usury is not cured by renewals; the taint remains through refinancing. The patterns of miscalculations and mistakes inherent in the lender's approach may not surface in one refinancing event

149 Usury usually "taints" succeeding contracts, so the later loans are vulnerable to challenge. Usury may be hidden behind a detailed flip and rebate.

150 *See* 6.8.3 *supra*.

151 *See, e.g.*, Countryman, *Improvident Credit Extension*, 27 U. ME. L. REV. 1 (1975).

152 *See* 4.5 *supra*.

153 For example, wrap-around mortgages may be usurious because the principal is smaller than claimed. *See* § 8.5.6 *supra*. In general, if it is claimed that the loan uses a principal amount greater than is legally recognized, the actual interest rate on the actual transaction goes up. It is sometimes claimed that wrap-around mortgages include the principal balance in the first mortgage as well as the new credit. If the first mortgage's principal is not legally includable, interest charges only applicable to the smaller amount of the second mortgage increase and may be usurious.

154 If prohibited, such charges are considered an interest for usury purposes.

155 If the renewal contract does not show where the loan proceeds went, ask the client. Lenders usually issue prepayment checks to themselves, so their records will also show which loans were flipped or refinanced.

Appendix 7

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October 29, 1986

To: Jeri Gautschi

From: Bob Dunn

Re: Finance Company Study

In researching Maine's "36 Month Limitation," debate has often arisen regarding the role that finance companies play in personal bankruptcy. Those in favor of this law believe that the actions of finance companies result in personal bankruptcy and thus the law is "for the good of the consumer." The opposition to this law argue that finance companies' actions are not a precursor to personal bankruptcy. A report by the General Accounting Office of the United States, "Bankruptcy Reform Act of 1978 -- A Before and After Look," provides some interesting insight to this debate. This report compares personal bankruptcies filed under chapters 7 and 13 before and after the implementation of the act in five bankruptcy court districts (eastern and southern New York, southern Ohio, eastern Kentucky, and central California).

Chapter 7 provides for liquidation and distribution of the debtor's nonexempt assets, if any, to creditors. Chapter 13, however, does not require that property be surrendered for liquidation and distribution to creditors. Instead, it provides debtors the opportunity to retain their assets if they agree to pay creditors over time.

The Bankruptcy Reform Act of 1978 was enacted on November 6, 1978, and became effective on October 1, 1979. Being the first comprehensive revision to the bankruptcy statutes since 1938, it was intended to make bankruptcy more efficient by consolidating procedures and balancing more equitably the interests of different classes of creditors. Federal exemptions were also introduced which allowed debtors to protect certain property from liquidation and distribution to creditors and expanded the opportunities for debtors to repay debt out of future income.

Table 1, derived from the GAO report, represents various sources of debt as a percentage of total debt for chapter 7 debtors for two time periods, prior to and after the Bankruptcy Reform Act of 1978. These percentages are based on a survey conducted by the General Accounting Office of the United States of 215 chapter 7 debtors. Debt was broken down into three categories; priority, secured, and unsecured. Priority debts are debts that are entitled to priority payments. Secured debts are debts upon which the creditor holds a lien on the property. Unsecured debts are debts upon which the creditor does not hold a lien on the property.

Table 1
Chapter 7 Debtors

Type of Debt	Percentage of Total Debt: Prior to Bankruptcy Reform Act of 1978	Percentage of Total Debt: After the Bankruptcy Reform Act of 1978
Priority Debt		
Business-related	2.8	1.0
Nonbusiness-related	.9	2.8
Total Priority Debt	3.7	3.8
Secured Debt		
Banks, Savings & Loans	20.5	25.9
Finance Companies	7.6	12.1
Credit Unions	1.9	.8
Individual Loans	.3	.4
Automobile Finance Companies	1.7	1.8
Other	5.2	5.8
Total Secured Debt	37.2	46.8
Unsecured Debt		
Banks, Savings & Loans, Credit Unions	10.2	6.3
Finance Companies	3.8	3.4
Business-related	11.1	9.7
Individual Loans	3.8	1.5
Credit Cards	6.8	6.1
Student Loans	1.0	.4
Retail Accounts	4.8	3.4
Service Accounts	2.2	2.4
Medical Expenses	3.6	2.4
Lawsuits	8.1	9.3
Other	3.7	4.5
Total Unsecured Debt	59.1	49.4
Total Debt	100.0	100.0

As shown in Table 1, unsecured debt represents the greatest percentage of debt for chapter 7 debtors both prior to (59.1%), and after (49.4%) the enactment of the Bankruptcy Reform Act of 1978. Prior to enactment, finance companies represented 3.8% of chapter 7 debtors' total unsecured debt, falling to 3.4 after the Bankruptcy Reform Act of 1978. However, the percentage of total debt that finance companies represent rose, from 11.4% prior to the enactment of the Bankruptcy Reform Act, to 15.4% after its enactment.

Table 2
Chapter 13 Debtors

	Percentage of Total Debt	
Type of Debt	Prior to Bankruptcy Reform Act of 1978	After the Bankruptcy Reform Act of 1978
Priority Debt		
Business-related	0.0	1.1
Nonbusiness-related	.8	2.2
Total Priority Debt	.8	3.3
Secured Debt		
Banks, Savings & Loans	51.2	45.0
Finance Companies	10.6	11.1
Credit Unions	2.0	1.3
Individual Loans	.5	1.0
Automobile Finance Companies	2.8	2.2
Other	6.2	4.3
Total Secured Debt	73.3	64.9
Unsecured Debt		
Banks, Savings & Loans, Credit Unions	5.4	8.4
Finance Companies	4.9	4.9
Business-related	.2	4.2
Individual Loans	.3	.9
Credit Cards	3.9	4.5
Student Loans	.5	1.2
Retail Accounts	4.1	2.6
Service Accounts	1.2	1.0
Medical Expenses	2.1	1.2
Lawsuits	.9	.4
Other	2.4	2.5
Total Unsecured Debt	25.9	31.8
Total Debt	100.0	100.0

Table 2, also derived from the GAO report, presents the same information for chapter 13 debtors as Table 1 did for chapter 7 debtors. Unlike chapter 7 debtors, secured debt represents the greatest portion of chapter 13 debtors total debt. Prior to the enactment of the Bankruptcy Reform Act of 1978 secured debt accounted for 73.3% of chapter 13 debtors total debt, falling to 64.9% after its enactment. In the period prior to the enactment of the Bankruptcy Reform Act of 1978, debt owed to finance companies accounted for 10.6% of chapter 13 debtors secured debt, rising modestly to 11.1% after its enactment. During the same two periods, debt owed to finance companies accounted for 15.5% and 16.0% respectively.

These percentage figures can not be expected to resolve the debate concerning the role that finance companies play in personal bankruptcy. They serve only the purpose of accounting for the percentage of debt that a debtor owes to various creditors.

According to both chapter 7 and chapter 13 questionnaire respondents, the most significant factors which contributed to their financial difficulties were, (frequency of response for chapter 7 and chapter 13 debtors presented in parenthesis) the increase in the cost of living (67%, 72%), periods of unemployment (36%, 34%), and financial management problems such as too many debts and too easy access to credit.

Source:
"Bankruptcy Reform Act of 1978 -- A Before and After Look", U.S. General Accounting Office, Comptroller General, July 20, 1983.

RD|7357M

SURVEY RESULTS February, 1986
Conducted by the Bureau of Consumer Credit Protection

Minimum Dollar Amounts Financial Institutions Will Lend on an Installment Loan Basis

TRUST COMPANIES

Name of Financial Institution	Minimum Dollar Amount of Loan
AROOSTOOK TRUST COMPANY Caribou, ME 04736	$ 300
BAR HARBOR BANKING AND TRUST Bar Harbor, ME 04609	750
BORDER TRUST COMPANY Jackman, ME 04945	No minimum
DAMARISCOTTA BANK AND TRUST Damariscotta, ME 04543	1,000
DIRIGO BANK AND TRUST Augusta, ME 04330	500
KATAHDIN TRUST COMPANY Patten, ME 04765	500
KEY BANK OF CENTRAL MAINE Augusta, ME 04330	1,000
KEY BANK OF EASTERN MAINE Bangor, ME 04401	1,000
KEY BANK OF NORTHERN MAINE Fort Fairfield, ME 04742	1,000
KEY BANK OF SOUTHERN MAINE Portland, ME 04111	1,500
LIVERMORE FALLS TRUST COMPANY Livermore Falls, ME 04254	500
THE MERRILL TRUST COMPANY Bangor, ME 04401	800
NORSTAR BANK OF MAINE Portland, ME 04101	1,000
OXFORD BANK AND TRUST Oxford, ME 04270	300
PEPPERELL TRUST COMPANY Biddeford, ME 04005	1,000

UNION TRUST COMPANY OF ELLSWORTH Ellsworth, ME 04605	$ 1,000
UNITED BANK Bangor, ME 04401	1,000

SAVINGS AND LOAN ASSOCIATIONS

AUBURN SAVINGS AND LOAN ASSOCIATION Auburn, ME 04210	$ 500
AUGUSTA FEDERAL SAVINGS Augusta, ME 04330	1,000
BAR HARBOR SAVINGS AND LOAN ASSOCIATION Bar Harbor, ME 04609	No installment lending
OXFORD BANK AND TRUST Mechanic Falls, ME 04256	300
ROCKLAND SAVINGS AND LOAN ASSOCIATION Rockland, ME 04841	No minimum
SUN SAVINGS AND LOAN ASSOCIATION Portland, ME 04111	2,500
WATERVILLE SAVINGS AND LOAN ASSOCIATION Waterville, ME 04901	500

SAVINGS BANKS

ANDROSCOGGIN SAVINGS BANK Lewiston, ME 04240	$ 1,000
BANGOR SAVINGS BANK Bangor, ME 04401	1,500
BATH SAVINGS INSTITUTION Bath, ME 04530	2,000
BIDDEFORD SAVINGS BANK Biddeford, ME 04005	1,000
COASTAL SAVINGS BANK Portland, ME 04101	1,000
FRANKLIN SAVINGS BANK Farmington, ME 04938	1,000

GARDINER SAVINGS INSTITUTION Gardiner, ME 04345	$ 500
GORHAM SAVINGS BANK Gorham, ME 04038	500
KENNEBEC SAVINGS BANK Augusta, ME 04330	500
KENNEBUNK SAVINGS BANK Kennebunk, ME 04043	2,000
KINGFIELD SAVINGS BANK Kingfield, ME 04947	500
MACHIAS SAVINGS BANK Machias, ME 04654	500
MAINE SAVINGS BANK Portland, ME 04101	500
MECHANICS' SAVINGS BANK Auburn, ME 04210	500
NORWAY SAVINGS BANK Norway, ME 04268	1,000
PEOPLES HERITAGE SAVINGS BANK Portland, ME 04111	2,500
SACO & BIDDEFORD SAVINGS INSTITUTION Saco, ME 04072	1,000
SANFORD INSTITUTION FOR SAVINGS Sanford, ME 04073	200
SKOWHEGAN SAVINGS BANK Skowhegan, ME 04976	500

ASSET/DEPOSIT/LOAN DISTRIBUTION BY FACILITY TYPE

December 31, 1985 Appendix 9

(000's omitted)

	1950	1970	1984	1985
Commercial Banks				
~~Trust Companies~~				
(Banks-Branches)	(30-62)	(20-124)	(17-196)	(17- 204)
Assets	254,670	772,491	2,591,459	2,924,859
Deposits	230,675	624,654	2,171,703	2,424,059
Loans	98,802	434,083	1,587,037	1,791,085
National Banks				
(Banks-Branches)	(32-8)	(19-103)	(9-126)	(8- 110)
Assets	241,290	730,210	1,992,059	2,269,427
Deposits	216,129	629,660	1,736,905	1,941,602
Loans	77,204	432,189	1,207,928	1,496,641
Thrift Institutions				
Savings Banks				
(Banks-Branches)	(32-1)	(32-24)	(20-114)	(19- 118)
Assets	273,695	1,022,172	3,737,016	4,117,423
Deposits	237,742	927,892	3,359,110	3,650,885
Loans	55,652	697,324	2,384,491	2,716,207
Federal Savings Banks				
(Banks-Branches)			(4-10)	(5- 10)
Assets			210,650	282,868
Deposits			187,624	248,686
Loans			144,028	192,311
State Savings & Loans				
(Assns.-Branches)	(30-0)	(18-2)	(7-12)	(4- 0)
Assets	35,515	107,762	401,053	75,862
Shares	26,085	94,895	312,411	67,296
Loans	32,153	93,617	233,099	57,802
Federal Savings & Loans				
(Assns.-Branches)	(5-0)	(9-3)	(6-4)	(7- 13)
Assets	7,823	119,976	223,327	509,664
Shares	5,086	101,248	204,666	404,943
Loans	2,519	103,208	182,807	314,451
Special and Restricted Service Facilities				
(Cr. Uns.-Branches)	(8-2)	(29-2)	(21-3)	(18- 3)
Assets	1,313	25,801	104,237	133,053
Shares	1,019	21,627	95,661	122,990
Loans	1,059	22,874	75,412	84,555
Federal Credit Unions				
(Cr. Uns.-Branches)	(42-0)	(171-2)	(121-3)	(118- 5)
Assets	1,648	93,774	606,564	758,166
Shares	1,442	78,321	552,398	696,436
Loans	971	77,868	411,853	476,236
Industrial Banks				
(Banks-Branches)	(2-1)	(8-6)	All in process of liquidation	
Assets	979	14,114		
Deposits	474	3,911		
Loans	755	11,649		

Appendix 10

Locations of Credit Unions

in Maine as of December 31, 1985

Auburn

Auburn Federal
Municipal Employees of Auburn Federal
New Auburn Federal

Augusta

Capitol Area Federal
Circle-W Credit Union
CMP Employees Federal
East Augusta Federal
Kennebec County Federal
Kennebec Valley Medical Center Federal
Maine Teachers Association
Maine State Employees
St. Augustine Federal
St. Mary's - St. Matthew's Federal

Bangor

Bangor Federal
Bangor Hydro Federal
Banme Federal
Bansco Federal
Eastern Maine Federal
Lucerne Federal
St. Mary's - St Matthew's Federal

Bar Harbor

Jax Lab Federal

Bath

Bath Area Community Federal
Bath Iron Works Federal

Biddeford

St. Andre's Federal
St. Joseph's Federal

Bowdoinham

Bowdoinham Federal

Brewer

Brewer Federal

Brunswick

Midcoast Federal
St. John's (Brunswick) Federal

Bucksport

Seaboard Federal

Cape Elizabeth

Jordans Employees Federal

China

LaVerdiere's Employees Federal

Damariscotta

Fisherman's
Lincoln County Federal

Dexter

Dexter Regional Federal

Dixfield

Forest Industries Federal

East Millinocket

East Millinocket Federal

Fairfield

Keyes Fibre Federal

Falmouth

Cumberland County Teachers Federal
Portland Maine Transit Federal

Farmington

Franklin County Federal
Mt. Blue Federal

Fort Kent

Fort Kent Federal

Gardiner

Gardiner Area Federal
Gardiner Federal
Health-Tex Employees Federal

Gorham

Gorham Regional Federal

Houlton

Houlton Federal

Howland

Howland - Enfield Federal

Jay

Otis Division Federal

Lewiston

Aerotred Federal
Community
K of C #106
Lewiston Municipal Federal
Rainbow Federal
Sainte Famille Federal
St. Croix Federal
Ste. Marie Federal

Lille

Grand Isle Community Federal

Limestone

The County Federal

Lincoln

Lincoln Maine Federal

Lisbon Falls

Lisbon Community Federal

Livermore Falls

Friendly Service

Madawaska

Fraser Employees Federal
Madawaska/Frenchville Federal

Madison

Madison - Anson Community Federal

Mexico

Oxford Federal

Millinocket

BARCO Federal
Katahdin Federal

Monmouth

Monmouth Federal

Monson

Moosehead Federal

North Berwick

Hussey Employees Federal

North Vassalboro

Vassalboro Federal

Oakland

Messalonskee Regional Federal

Old Orchard

Old Orchard Beach Federal

Old Town

Penobscot Federal

Orono

University of Maine Employee
University of Maine Student Federal

Pittsfield

Peoples Regional Federal

Portland

Blue Cross and Blue Shield of Maine Employees
Government Employees
Thomas Laughlin Employees Federal
Maine Turnpike
MEBS Federal
Burnham & Morrill Employees
Nissen Employees Federal
Maine Osteopathic
PM & B Federal
Portland Regional Federal
Portland Maine Police Department Federal
Portland Maine City Employee Federal
Railroad Workers Credit Union of Maine
Sanborn's Federal
Portland Maine Teachers Federal
Southworth Federal

Portland (continued)

Emery Waterhouse Employees
Hannaford Employees Federal
Medical Services Federal
Press Herald Federal
Union Mutual Employees

Rockland

Knox County Federal

Rumford

RCH Federal
RMD Federal

Sabattus

Sabattus Regional

Saco

Saco Valley Federal

Sanford

Sprague Sanford Federal
Springvale Federal
St. Ignatius Federal
York County Teachers Federal

Skowhegan

Skowhegan Community Federal

South Paris

NOPAR Federal

South Portland

Fairchild Semiconductor Federal
Holy Cross
Mobil Portland Federal
South Portland Municipal
St. John's Federal

St. Agatha

St. Agatha Federal

St. Francis

St. Francis Community Federal

Van Buren

Gateway Federal

Waterville

Berean Federal
Keyes Fibre Federal
Mid-Maine Medical Center Federal
Notre Dame Waterville Federal
Sentinel Employees Federal
St. Francis de Sales Federal

Wells

Shaw's Employees Federal

Westbrook

S. D. Warren Federal

West Peru

Woodworkers Federal

Winslow

Taconnet Federal
Winslow Community Federal

Wintrhop

Winthrop Area Federal

Woodland

St. Croix Federal

SURVEY ON FINANCE COMPANY* ACTIVITY AND REGULATION

Appendix 11

*Please Note: This questionnaire seeks information on loan companies and not industrial banks, and the like, which may also be licensed entities in your state.

B A C K G R O U N D

1. PERSON COMPLETING:______________________ TITLE:___________

2. YOUR STATE:________________

3. STATE POPULATION:_______________

4. NUMBER OF INDIVIDUAL FINANCE COMPANIES IN YOUR STATE:_______

5. NUMBER OF BRANCH OFFICES:_________ TOTAL:________

6. FINANCE COMPANY LOANS: Please provide information on both the number and total dollar amount of consumer loans made by finance companies in the last three years:

	Number of Loans	Total Dollar Amount of Loans
198__		
198__		
198__		

7. NUMBER OF CREDIT UNIONS IN YOUR STATE (including any branches): ___________

8. CREDIT UNION LOANS: Please provide information on both the number and total dollar amount of consumer loans (excluding first mortgages) made by credit unions in the last three years:

	Number of Loans	Total Dollar Amount of Loans
198__		
198__		
198__		

9. NUMBER OF OTHER SUPERVISED FINANCIAL ORGANIZATIONS (SFOs)(i.e., commercial banks, savings banks, S & Ls, industrial banks, etc.) in your state (including any branches):____________________

10. SFO CONSUMER LOANS: Please provide information on both the number and total dollar amount of consumer loans (excluding first mortgages) made by SFOs in the last three years:

	Number of Loans	Total Dollar Amount of Loans
198__		
198__		
198__		

ADMINISTRATION AND REGULATION

11. EXAMINATIONS:

    A. Number of Finance Company examinations in 1985__________
    B. Number or Percentage of Examination Staff involved in Finance Company examinations______________________________
    C. How are exams conducted? Field Exams? By Mail?________

    ____

12. REGULATORY ENFORCEMENT POWERS (e.g., independent license suspension and revocation powers or through court, etc. Please explain.) ____

    ____

    ____

13. NUMBER OF LICENSE SUSPENSIONS, REVOCATIONS, OR OTHER ADMINISTRATIVE OR JUDICIAL ACTIONS BROUGHT BY YOUR OFFICE IN LAST 3 YEARS. (Please specify how many of each.)_________________

    ____

14. STATUTORY RATE CEILINGS (IF ANY) ON LOAN PRODUCTS (small loans, second mortgages, etc.)______________________________________

    ____

    ____

15. DO YOU HAVE AN "INTEREST AFTER MATURITY" RATE THAT APPLIES TO LOANS NOT PAID OUT ACCORDING TO SCHEDULE? If so, please describe this provision of your law. (Please give a cite or enclose a copy.)____

    ____

    ____

VIOLATIONS AND COMPLAINTS

16. MOST COMMON FINANCE COMPANY VIOLATION NOTED IN YOUR EXAMINATIONS, OR BASED ON YOUR EXPERIENCE:________________________

    ____

    ____

17. MOST COMMON CONSUMER COMPLAINT, IF DIFFERENT:_______________

    ____

    ____

18. NUMBER OF PRIVATE LAWSUITS, INCLUDING CLASS ACTIONS BROUGHT AGAINST FINANCE COMPANIES IN LAST 3 YEARS THAT YOU KNOW ABOUT:

    ____

    ____

    ____

19. PLEASE ENCLOSE A COPY OF YOUR OFFICE'S MOST RECENT ANNUAL REPORT, IF YOU ISSUE ONE.

TRENDS

20. WHAT HAS BEEN YOUR OBSERVATION ABOUT THE MINIMUM SIZE OF LOANS MADE BY FINANCE COMPANIES OVER LAST 5 YEARS - INCREASING, DECREASING, STAYING THE SAME?____________________

21. WHAT IS THE AVERAGE MINIMUM LOAN SIZE NOW?____________________

22. WHAT IS THE TREND REGARDING OPEN-END VS. CLOSED-END CREDIT IN YOUR STATE BY FINANCE COMPANIES?____________________

23. WHAT IS THE TREND ON THE USE OF COLLATERAL FOR LOANS? ARE LICENSED LENDERS MAKING FEWER UNSECURED LOANS?____________________

24. DO YOU FEEL THAT ALL CREDITWORTHY SEGMENTS OF SOCIETY IN YOUR STATE ARE RECEIVING THE CREDIT THEY NEED OR ARE ENTITLED TO? (Please elaborate on why you answer "Yes" or "No." For example, have there been any recent changes in credit law or regulation in your state that have affected this situation?)____________________

THANK YOU VERY MUCH!

IF YOU WOULD LIKE THE RESULTS OF THIS SURVEY, PLEASE CHECK HERE. /__/

PLEASE RETURN TO:

ROBERT A. BURGESS, SUPERINTENDENT
BUREAU OF CONSUMER CREDIT PROTECTION
STATE HOUSE STATION #35
AUGUSTA, ME 04333

Appendix 12

ADMINISTRATIVE POWERS

The following states indicated in the survey conducted by the Bureau of Consumer Credit Protection that the licensing agency also had the authority to administratively suspend or revoke licenses.

SYMBOLS USED: S = SUSPENSION R = REVOCATION H = HEARING REQUIRED

1.	ALABAMA	S, H	14.	MICHIGAN	S/R
2.	ALASKA	R, H	15.	MINNESOTA	S/R, H
3.	COLORADO	S/R, H	16.	MISSISSIPPI	S
4.	CONNECTICUT	S/R	17.	MONTANA	S/R
5.	FLORIDA	S/R	18.	NEVADA	S/R, H
6.	HAWAII	S/R	19.	NEW YORK	S/R, H
7.	IDAHO	S/R	20.	OHIO	R
8.	INDIANA	S/R, H	21.	OKLAHOMA	S/R
9.	IOWA	S, H	22.	OREGON	S/R
10.	KENTUCKY	R, H	23.	TENNESSEE	S/R, H
11.	LOUISIANA	S/R, H	24.	UTAH	S/R
12.	MARYLAND	S/R, H	25.	WASHINGTON	S
13.	MASSACHUSETTS	S/R, H			

Monthly Statistical Report

Appendix 13

June, 1986

Total Consumer Installment Credit and Credit at Finance Companies

(In millions of dollars)

	Outstanding			Net Change		
	June 1986	May 1986*	June 1985	This Month	Last Month*	12 Months
Consumer Installment Total	566,098	558,400	492,140	7,698	7,457	73,958
Commercial Banks	249,232	246,967	226,436	2,265	977	22,796
Finance Companies	134,735	130,271	105,971	4,464	3,211	28,764
Credit Unions	78,600	78,035	70,629	565	758	7,971
Retailers	39,445	39,493	37,709	-48	400	1,736
Savings Institutions	60,641	60,230	47,320	411	2,280	13,321
Gasoline Companies	3,445	3,404	4,075	41	-169	-630
Credit at Finance Companies Total	295,029	289,920	250,587	5,109	3,033	44,442
Consumer Installment Credit	134,735	130,271	105,971	4,464	3,211	28,764
Automobile	86,647	82,755	62,077	3,892	3,258	24,570
Mobile Home	8,984	8,998	9,061	-14	-142	-77
All Other	39,104	38,518	34,833	586	95	4,271
Business Credit	160,294	159,649	144,616	645	-178	15,678
Retail Comm.Vehicles	16,277	15,751	12,464	526	552	3,813
Retail Equipment	20,235	20,189	20,431	46	106	-196
Wholesale Auto	26,338	26,288	20,903	50	-293	5,435
Wholesale Equipment	4,817	4,745	4,709	72	36	108
All Other Wholesale	7,488	7,546	6,798	-58	-186	690
Auto Leasing	16,110	16,200	14,941	-90	81	1,169
Equipment Leasing	40,342	39,932	37,269	410	-156	3,073
Short-Term Business Credit	16,286	16,886	15,733	-600	43	553
All Other Intermediate Credit	12,401	12,112	11,368	289	-361	1,033
MEMO:						
Second Mortgages at Finance Companies	32,424	31,842	28,432	582	344	3,992

Source: Federal Reserve Board.
Note: Parts may not add to totals due to rounding.
* Revised.

Appendix 14

Merchant Questionnaire on Availability of Financing.

1. Did you ever offer your own Internal Financing? Yes ___ No ___

   a. If you did and no longer do, why did you stop?

   ____

   ____

   ____

2. If you don't offer your own financing, do you feel that all of the financing needs of your customers are currently being serviced, either by local lenders, use of bank credit cards, or sales financing plans offered by third party sales finance companies?

   ____

   ____

   ____

3. Have you ever had dealings with a Finance (Loan) Company either on a personal or a Business basis? Yes ___ No___

4. If answer to question #3 is yes, was your experience generally favorable or unfavorable?

   ____

   ____

   ____

5. Do you feel that the return of Finance (Loan) Companies to your area would be beneficial to you or your customers?

   ____

   ____

   ____

Code of Ethics

The members of the American Financial Services Association believe that the interest of the public, member companies, and industry employees can best be served through the voluntary observation of the following code:

1. The foundation of the consumer credit business is consumer confidence. Such confidence is created only by fair treatment, courtesy, and efficient service.

2. Members will explain fully to customers the cost, terms, and contractual obligations of credit transactions. Written instruments will be as simple, lucid, and unambiguous as circumstances will permit.

3. The business will be maintained as a constructive agency in community life, providing a considerate and responsible source of credit.

4. Truth in advertising will be the guiding principle of all promotional efforts thus enabling potential credit users to make an intelligent marketplace decision.

5. Advertising will not make disparaging references to competition nor will it deliberately imitate the copy, slogans or illustrations of a competitor.

6. The Association endorses the Code of Billing and Collection Practices recommended by the National Business Council for Consumer Affairs.

7. Association members support state laws which regulate and supervise this business and which give due regard to the public interest and encourage and safeguard the investment of capital.

8. Members will cooperate with supervising officials and other public authorities in the effective enforcement of laws and regulations governing the business, and will seek to secure universal observance of these standards and principles throughout the consumer credit business.

9. Members will support and cooperate with Better Business Bureaus, Chambers of Commerce, Boards of Trade, credit associations, welfare societies, and other public service agencies striving effectively to improve economic and social conditions of all Americans.

Collection Code

Preamble
Believing that the responsibility of this industry to serve the credit needs of the consumer is a public trust, we, the members of the American Financial Services Association, hereby proclaim and agree to follow this Collection Code.

Purpose
It will be our purpose as an industry to exhibit the same care and concern for a customer's past due account as was demonstrated when the original transaction occurred. The goal is to keep customers in good standing and to assist them should they experience difficulties in repayment.

Communicating with Third Parties for the Purpose of Locating the Customer
A creditor who communicates with any person other than the customer for the purpose of acquiring location information (the customer's home address, phone number, and place of employment) shall:
1. identify himself, state that he is confirming or correcting location information regarding the customer, and, only if expressly requested; identify his employer;
2. not state that the customer owes any debt;
3. not communicate with any such person more than once unless requested to do so by such person or unless the creditor reasonably believes that the earlier response of such person is erroneous or incomplete and that such person now has current or complete location information;
4. not use a post card, nor use any language or symbol on any envelope or other type of communication which can be seen or read by the public which indicates that the creditor collects debts, or that the communication relates to the collection of a debt;
5. only communicate with the customer's attorney if the creditor knows the customer is represented and can obtain the attorney's name and address, unless the attorney does not respond within a reasonable time.

Communicating with the Customer for the Purpose of Collecting a Debt
All communication with a customer regarding a debt shall:
1. be at reasonable hours (normally between 8:00 a.m. and 9:00 p.m.);
2. not be at the customer's place of employment if the creditor knows or has reason to know that the customer's employer prohibits the customer from receiving such communication;
3. be through the customer's attorney if the creditor knows the customer is represented and can obtain the attorney's name and address, unless the attorney does not respond within a reasonable time or the customer or his attorney consents to direct contact with the creditor.

For purposes of this section, the term "customer" includes the customer's spouse or parent (if the customer is a minor).

Communicating with Third Persons for the Purpose of Collecting a Debt
Except when attempting to locate a customer, a creditor shall not communicate, without the prior consent of the customer given directly to the creditor, or the express permission of a court of competent jurisdiction or as reasonably necessary to effectuate a post-judgment judicial remedy, in connection with the collection of any debt, with any person other than the customer, his attorney, a consumer reporting agency if otherwise permitted by law, or the attorney for the creditor.

For purposes of this section, the term "customer" includes the customer's spouse or parent (if the customer is a minor).

Ceasing Communication with the Customer and his Spouse with Respect to a Debt
If the customer notifies the creditor in writing that he refuses to pay the debt or that he wishes the creditor to cease further communication, then no further contact shall be made with the customer regarding the debt. However, the creditor may still notify the customer that certain legal remedies will be invoked if that is the case, and may still communicate with the customer's attorney.

Collection Practices
A creditor shall not engage in any conduct the natural consequences of which are to harass, oppress, or abuse any person in connection with the collection of any debt. Examples of harassment or abuse are contained in Section 806 of the Federal Fair Debt Collection Practices Act (15 U.S.C. 1692(e)).

A creditor shall not use any false, deceptive, or misleading representation or means in connection with the collection of any debt; nor shall the creditor design, compile, furnish, or use any form which creates the false belief in a customer that some other party is participating in the collection of a debt when in fact such party is not so participating. Examples of false or misleading representations are contained in Section 807 of the Federal Fair Debt Collection Practices Act (15 U.S.C. 1992(e)).

A creditor shall not use unfair or unconscionable means to collect or attempt to collect any debt. Examples of unfair practices are contained in Section 808 of the Federal Fair Debt Collection Practices Act (15 U.S.C. 1992(f)).

Validation of Debts
If a customer disputes a debt, the creditor shall take reasonable and responsible action to verify the existence of the debt and to resolve the complaint.

Multiple Debts
If a customer has more than one account with the creditor, all payments made shall be applied to such accounts as directed by the customer.

Legal Actions
If legal action is instituted by a creditor, suit shall be brought in the jurisdiction where the contract was made or where the customer resides, or in the case of any action to enforce an interest in real property securing the customer's obligation, where the real property is located.

Existing Collection Laws
The purpose of this Code is to establish uniform rules of conduct for creditors to follow when collecting their debts. It is recognized that some jurisdictions have existing laws providing similar or greater protection for the customer and this Code shall not affect those laws or alter any creditor's obligation to comply with such laws in addition to the Collection Code.

The American Financial Services Association Collection Code is based on the principles contained in the Federal Fair Debt Collection Practices Act.