Approved: 2/14/96
Date

MINUTES OF THE Senate Committee on Financial Institutions and Insurance.

The meeting was called to order by Chairperson Dick Bond at 9:15 a.m. on February 13, 1996 in Room 529-S of the Capitol.

All members were present.

Committee staff present: Dr. William Wolff, Legislative Research Department
Fred Carman, Revisor of Statutes
June Kossover, Committee Secretary

Conferees appearing before the committee: Bud Grant, Kansas Chamber of Commerce and Industry
Dr. Ray McAlister, University of North Texas

Others attending: See attached list

Senator Steffes made a motion, seconded by Senator Corbin, to approve the minutes of the meeting of February 12 as submitted. The motion carried.

The chairman opened the hearing on **SB 569**, concerning deregulation of finance charges on consumer credit sales. Bud Grant, KCCI, appeared as a proponent and sponsor of this bill, stating that since most national retailers now have deregulated credit operations, they can export rates into other states, including Kansas. As a result, only small Kansas retailers with self-contained credit operations are subject to the UCCC's statutory limitations. (Attachment #1)

Mr. Grant introduced Dr. Ray McAlister, Regents' Professor of Marketing at the University of North Texas. Dr. McAlister explained the difference between retail credit and other types of credit, such as bank loans and bank credit cards. (Attachment #2) Dr. McAlister stated that small retailers need new public policy that provides the freedom to price their products and services to recover the constantly increasing cost of doing business.

In response to Senator Hensley's question, Dr. McAlister advised that 38 states can charge higher interest rates than Kansas merchants and that it is not possible to control out of state rates, which can be imported into Kansas.

Dr. Wolff briefly explained the changes this legislation would make: in Section 1, closed end transactions which now are limited to an interest rate of 21% up to $1,000 in sales and 14.4% over $1,000 would be amended to allow the buyer and seller to negotiate an acceptable rate between them; and would strike the language in Section 2 which sets the formula for calculating the 21%/14.4% interest rate and add an allowance for an agreement to be reached between the seller and the buyer.

In response to Senator Emert's question regarding the extent of companies affected, Mr. Grant advised that the bill could affect anyone selling merchandise on credit,

There were no other conferees and no further questions. The hearing on **SB 569** was closed.

The committee adjourned at 9:53 a.m. The next meeting is scheduled for Wednesday, February 14.

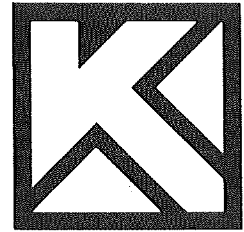
Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

SENATE FINANCIAL INSTITUTIONS & INSURANCE COMMITTEE GUEST LIST

DATE: 2/13/96

NAME	REPRESENTING
David Hanson	Ks Insur Assoc
Venesa Sullenauer	AmVestors
Bill Sneed	AmVestors
Danielle Noe	KCUA
Sue Bond	
Tom Wilder	Kan Insurance Dept
Ray McAlister	KCCI
Bud Grant	KCCI
Rogers Brazier	St. Treasurer
Gary Brelsford	GE Capital
George Barbee	Barbee & Assoc's
Kelley Kultala	KTLA
Roger Franzke	FFC

LEGISLATIVE TESTIMONY



Kansas Chamber of Commerce and Industry

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SB 569 February 13, 1996

KANSAS CHAMBER OF COMMERCE AND INDUSTRY

Testimony Before the

Senate Committee on Financial Institutions

by
Bud Grant
Vice President & General Manager

Mr. Chairman and members of the Committee:

My name is Bud Grant and I appreciate the opportunity to appear before you today in support of SB 569.

The Kansas Chamber of Commerce and Industry (KCCI) is a statewide organization dedicated to the promotion of economic growth and job creation within Kansas, and to the protection and support of the private competitive enterprise system.

KCCI is comprised of more than 3,000 businesses which includes 200 local and regional chambers of commerce and trade organizations which represent over 161,000 business men and women. The organization represents both large and small employers in Kansas, with 46% of KCCI's members having less than 25 employees, and 77% having less than 100 employees. KCCI receives no government funding.

The KCCI Board of Directors establishes policies through the work of hundreds of the organization's members who make up its various committees. These policies are the guiding principles of the organization and translate into views such as those expressed here.

When Kansas enacted the Uniform Consumer Credit Code (UCCC) in 1974, it joined with nine other states. Although it is hard to believe for some of us, that action was 22 years ago. And just as we have changed, so has the world of retail credit.

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Attachment #1

As you will note on the map attached to my testimony, 24 states have deregulated retail credit. Four of the UCCC states: Idaho, Maine, South Carolina, and Utah, have deregulated. Most national retailers now have established credit operations in a deregulated state. This allows them or export rates into other states, including Kansas. As a result, only those small Kansas retailers with self contained credit operations are subject to the UCCC's current statutory limitations.

I am pleased to have with me today Dr. Ray McAlister. Dr. McAlister is currently Regents' Professor of Marketing in the College of Business Administration at the University of North Texas. For the past 33 years, he has been teaching and conducting research in the area of consumer credit, particularly retail credit. Most recently, he has conducted studies of consumers' use of retail credit based on records from 16,000 accounts at 23 different retailers in California, Pennsylvania and Texas. Much of his research has been published in various articles, papers, and monographs. His testimony today will be based largely on findings from these studies of consumer credit law.

● OPEN COMPETITIVE RETAIL CREDIT MARKET

Over 18%

18% *

Washington
Oregon
California
Idaho
Nevada
Montana
Wyoming
Utah
Arizona
Colorado
New Mexico
North Dakota
South Dakota
Nebraska
Kansas
Oklahoma
Texas
Minnesota
Iowa
Missouri
Arkansas
Louisiana
Wisconsin
Illinois
Mich.
Indiana
Ohio
Kentucky
Tennessee
Miss.
Alabama
Georgia
Florida
S. Carolina
N. Carolina
Virginia
W. VA
MD.
Del.
N.J.
New York
Maine
VT.
NH.
Mass.
R.I.
Conn.
Hawaii

* Arkansas has variable rate below 18%

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RETAIL CREDIT FINANCE CHARGES--REGULATION VS. A "MARKET RATE" AND ITS EFFECT ON KANSAS

Kansas retailers are in business to sell products and services that meet the needs of Kansas consumers. To meet these needs, many merchants offer various types of credit arrangements to consumers.

Retail Credit is Different

Although most consumers have several sources of financing available, it is important--from a public policy viewpoint--to recognize significant differences existing between retail credit and other types of credit, such as bank loans and bank credit cards. These differences can be grouped into three main categories as follows: (1) use, (2) price, and (3) cost.

How Retail Credit Is Used. Most consumer loans and bank cards involve substantially larger amounts of money than is typical of retail credit accounts. Because of larger balances and longer repayment periods, finance charges paid by consumers on loans and bank cards can run into hundreds or, in the case of auto loans, thousands of dollars. In contrast, an average retail customer maintains a monthly balance of around $200, paying, on the average, no more than $30 to $40 a year in finance charges per account.[1] Studies indicate that more than 70 percent of retail customers avoid finance charges at least some of the time during the year. Furthermore, Federal Reserve survey data show that less than 44 percent of all families owe credit card debt (of all kinds, including bank).[2] Because of these characteristics, the finance charge rate paid on retail accounts has a much smaller impact on consumer pocketbooks than does the rate on other indebtedness.

How Other Credit Plans Are Priced. Consumers can use retail credit cards without paying any annual fees. They can even use their accounts without paying any finance charge, that is, enjoy a "grace period"--by paying their bills in full each month (something about one-third of customers do consistently and about 40 percent do occasionally). Merchants have only **one source** of credit revenue--that is, the monthly finance charge from those customers who do not pay in full. In contrast, bank cards have **two or three** potential **sources** of revenue to offset the cost of offering credit services--**annual fees**, monthly finance charges paid by customers not paying in full, and a "discount" ranging from 2 to 6 percent of the amount of the sales ticket which is paid by the merchants. Sometimes, bank cards (those with very low APRs) charge from the day of purchase--that is, allow no "grace period" or time within which payment can be made without incurring a finance charge.

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Attachment #2

Bank **loans** usually involve lower APRs (finance charge rate) than both retail and bank credit cards, but there is no "grace period" on loans--meaning that interest is paid every day from the day the loan is made until it is repaid. The result of this difference is that a bank loan can actually **cost more** than a credit card under some circumstances even though the APR may be lower.

The Cost of Operating Credit Plans. Loans, in addition to involving substantially larger amounts and higher total finance charges, are **less expensive** to administer than are credit cards. Credit cards involve extensive manpower--keeping track of multiple transactions each month, preparing monthly billing statements, etc. Some expenses, such as a credit report, are the same on a loan of $20,000 as on a retail account averaging $200 a month. Obviously, smaller transactions would require a higher finance charge rate to cover these costs.

Retailers Need Public Policy That Provides Two Things

In order to survive in a very competitive environment, retailers need two things from those establishing public policy:

(1) a level playing field relative to its competitors, and
(2) freedom to price its products and services to recover constantly increasing costs of doing business.

A Level Playing Field. The present Kansas rate ceiling of 14.4 percent on balances above $1,000 produces an effective rate on many accounts that is **below market-driven rates existing nationally.** Thirty-eight states permit 21 percent or more on any balance size. Twenty-four (24) states have no ceilings at all.

As a result of this environment, the following have occurred. First, Kansas **retailers cannot cover their costs** of offering credit services. An inadequate finance charge rate can produce the following undesirable results:

a) Credit becomes harder to get, particularly for those with less income, with limited credit histories, with new jobs, etc.

b) Households, having been excluded from many traditional sources of credit, are forced to use higher-cost alternatives, such as using a laundromat or a "rent-to-own" plan instead of buying a washing machine.

c) Merchants must charge higher prices to make up for credit losses.

Second, some Kansas residents are still being charged rates higher than the rate allowed by state law because of rates that are being "exported" into Kansas in three different ways: (a) by use of traditional bank cards (MasterCard, VISA, and Discover), or (b) establishment of "credit card banks" by larger retailers, or © use of "private-label third-party" cards--that is, credit plans custom-designed for merchants and their customers but operated by a national bank. In all of these cases, rates being charged by national banks chartered in states like Delaware, Maryland, Ohio, and South Dakota are not subject to Kansas limitations under what is commonly known as the "Marquette decision." Thus, **current Kansas regulations impact solely on local merchants who either by necessity or by choice do not use the techniques described above for exporting rates.** This problem is especially severe in many smaller communities with limited access to credit services.

Why Are Current Rate Ceilings Not Enough for Retailers When Many Short-Term Rates ("prime", for example) Are So Low?

A number of factors are relevant to this question. (1) Unlike home loans and auto loans, money cost is usually **no more than one-half** of the total cost **(and often less)** incurred in offering retail credit services. (2) The other one-half of retail credit operating costs (made up of postage, payroll, bad debt, etc.) has never gone any way but up. For example, since 1980 the following have increased (while many short-term measures of money cost--prime, T-Bills, etc.--have declined):

Cost Factor	*1980*	*1994*	*% Increase*
Postage	$0.15	$0.32[a]	113%
Employment Cost Index[b]			
● Wages & Salaries	66.2	119.1	80%
● Benefits	59.1	132.3	124%
● Total	64.2	122.6	91%

a) As of January, 1995.
b) June, 1989 = 100; The Index is a measure of the change in the cost of labor, free from the influence of employment shifts among occupations and industries. Department of Labor, Bureau of Labor Statistics. ECONOMIC REPORT OF THE PRESIDENT, 2/95, p.

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(3) Even the cost of funds that retailers use to finance their credit operations has not changed significantly since 1980. The rates which have declined since 1980 have been **short-term** interest rates such as the "prime" and Treasury Bills. Movements in short-term rates are not at all an accurate measure of the cost of funds for retailers since retailers do not rely primarily on short-term funds. Rather, retailers use a combination of equity and debt with about 80% of the debt being **long-term**. Consequently, retailers' costs of funds are still high relative to earlier years.

What Happens If Rate Ceilings Are Removed?

Many times there is concern that consumers will be drastically effected if ceilings are removed. Research data provides some interesting facts about the price of credit in states where ceilings have been removed. One survey of seventeen states which had **no finance charge ceilings at the time** (1988-89), found that 87 percent of all firms surveyed were charging 21 percent or less.[3] A more recent survey conducted in Washington State (1995) provided further evidence of how competitive markets work. With retail credit card ceilings having been removed in 1992, this 1995 survey documented that 73.5 percent of those reporting had not changed their rate of charge. Similar evidence (although a much smaller sample) was found in Connecticut more than a full year following removal of rate ceilings where none of four major retail firms surveyed had changed their rate.

Removal of statutory rate ceilings has produced some positive results in terms of increased credit availability for consumers. Firms responding to initial research in both Washington State and Connecticut indicated that the following factors had increased after removal of ceilings: number of active accounts, dollar receivables, average credit limits and percentage of applicants approved for new credit. In particular, these firms indicated that the following types of consumers would benefit from the new legal environment: those with lower incomes, renters, people newly married, people new on the job, new residents in the state, and those having limited, weak, or no previous credit history.

Summary

(1) Retail credit for the great majority of Kansas consumers is probably the **best deal in town** even if the APR is higher than that charged on some other types of cards which have fees. Retail cards are less expensive, in many instances, than loans because loans do not allow an "interests-free" grace period whereas retail cards do. Likewise, retail cards can be less expensive than bank cards which charge annual fees or have no grace period.

(2) Rate ceilings are **largely ineffective** because of factors beyond the control of any single state and produce results which are detrimental to the interests of many consumers.

(3) Low rate ceilings reduce credit availability to many creditworthy consumers, force consumers to use higher-priced alternatives, force merchants to raise merchandise prices, and put local Kansas merchants at a competitive disadvantage compared to out-of-state operations.

(4) An open competitive market produces more choices for Kansas consumers at prices that are reasonable in view of changing costs of operation. With a larger number of alternatives, informed customers can make the choices which best meets their needs.

Notes:

(1) Dr. Ray McAlister, CALIFORNIA RETAIL REVOLVING CREDIT: ITS PRICE AND USE RELATIVE TO OTHER STATES, Management Information Series No.11, Merchants Research Council, Chicago, Illinois, Dec., 1989; Dr. Ray McAlister, AN ANALYSIS OF RETAIL REVOLVING CREDIT USE IN TEXAS, Univ. of North Texas, Dec., 1990; Dr. Ray McAlister, AN ANALYSIS OF RETAIL REVOLVING CREDIT USE IN PENNSYLVANIA, University of North Texas, February, 1993.

(2) Arthur B. Kennickell and Martha Starr-McCluer, FEDERAL RESERVE BULLETIN, October, 1994, p. 877.

(3) McAlister, CALIFORNIA RETAIL REVOLVING CREDIT: ITS PRICE AND USE RELATIVE TO OTHER STATES, Management Information Series No.11, Merchants Research Council, Chicago, IL, Dec., 1989.

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AN ILLUSTRATION OF TOTAL FINANCE CHARGE
REVENUE AND GROSS FINANCE CHARGE YIELD ON A REVOLVING ACCOUNT

Assumptions:

Original purchase balance........$100.00
Payment size $10.00
Day on which payments are due..... 16th
Annual Percentage Rate............ 21%
Number of Payment Periods......... 12
Minimum Finance Charge............$0.50

Month	Unpaid Balance	Payment	Avg. Daily Bal.	f/c
1/ 1	$100.00	$ 0.00		
1/31	100.00		$100.00	$0.00[a]
2/16	90.00	10.00		
2/28	91.67		95.36	1.67
3/16	81.67	10.00		
3/31	83.17		85.70	1.50
4/16	73.17	10.00		
4/30	74.52		77.42	1.35
5/16	64.52	10.00		
5/31	65.73		68.71	1.20
6/16	55.73	10.00		
6/30	56.78		60.12	1.05
7/16	46.78	10.00		
7/31	47.67		51.11	.89
8/16	37.67	10.00		
8/31	38.41		42.08	.74
9/16	28.41	10.00		
9/30	28.99		33.04	.58
10/16	18.99	10.00		
10/31	19.49		23.55	.50*
11/16	9.49	10.00		
11/30	9.99		14.24	.50*
12/16	.00	9.99		
12/31	.00		4.59	.00[b]
Total		$109.99	$655.91	**$9.99**

* Fifty-cent "minimum" finance charge

Average Daily Balance = $655.91/12 = $ 54.66

Gross Finance Charge Yield = $9.99 FC/$54.66 ADB = **18.3%**

Notes: (a) No finance charge when previous month's unpaid balance was zero.
(b) No finance charge when previous month's unpaid balance is paid in full.

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