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INTEREST RATE CEILINGS SUBJECT OF CONSUMER CREDIT LEGISLATION

By Noel Larrivee
UM Information Services

(Editor's note: This is the fourth in a series of six articles designed to explain HB 584, the Uniform Consumer Credit Code (UCCC) bill now pending before the Montana legislature. This article explains the confusion surrounding existing interest rate ceilings in Montana and will be followed by the objectives of the UCCC in simplifying the interest rates in the fifth article.)

MISSOULA--

Only an expert can understand the rate ceilings on consumer credit which have been patched together in Montana--and even he might stumble once in a while.

For example, in Montana a "usury law" apparently sets a ceiling of 10 per cent per year on consumer credit. But in most cases that ceiling was bypassed because of changes in technology or the economy, and special laws have allowed for "exceptions" for small loans, installment buying, credit cards, and revolving charge accounts. Now the exceptions are more often the rule, but the rules are very complicated and differ among credit grantors.

Most of the complicated rate ceilings do not appear in the hodgepodge of laws in the actuarial terms now demanded by federal "Truth in Lending" legislation. Actuarial rates are based on payments on declining balances. Disguised rates such as "add-ons" and "discounts" usually are paid on original balances and are much higher than they appear on the surface.

This can be demonstrated by Montana retail installment sales rate ceilings. They are listed in the form of "add-ons." This means that the cost of the credit is added to the cost of the item charged. Therefore, if the price of a television set is \$100, the buyer will pay an add-on rate of \$11 which means he must repay \$111 in installments. That amounts to an annual actuarial rate of 19.72 per cent on a 12-month contract.

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Another method of concealing real rates can be found in the Montana Morris Plan Company law. This is the discount method. Through this device a consumer who borrows \$100 for one year at a "discount" rate of 10 per cent plus a fee must repay \$125.53, which makes the actuarial rate for the loan about 25.5 per cent. To put it another way, if the discount were 10 per cent, a consumer signing a one-year note for \$100 finds that the \$10 finance charge is discounted--taken away at the start--so that he actually receives only \$90.

Under the retail sales law in Montana for goods and services other than automobiles, there is an \$11 add-on for credit up to \$300; a \$9 add-on between \$300 and \$1,000; and a \$7 add-on for the portion over \$1,000. This means that on a one-year installment contract for \$1,200, three actuarial rate ceilings would apply: on the \$200 portion of the loan above \$1,000, the actuarial rate ceiling would be 12.68 per cent; the \$700 portion between \$300 and \$1,000 would have a rate ceiling of 16.22 per cent; and for the first \$300, a 19.72 per cent ceiling would apply.

Rate ceilings are equally complicated for motor vehicles with add-ons ranging from \$7 for new cars to \$11 for four-year-old cars. However, there is a minimum charge of \$20.

Although they have several levels, rate ceilings in the Montana Consumer Finance Act governing small loans are also on an "add-on" basis. For a loan or portion of a loan up to \$300 the rate ceiling is \$20 add-on or 35.1 per cent per year for one-year contracts. It is \$16 add-on (28.3 per cent per year) for that part of the loan between \$300 and \$500, \$12 add-on (21.5 per cent per year) for that portion of the loan between \$500 and \$1,000, and \$10 add-on (18.0 per cent) for the portion of the balance exceeding \$1,000.

Another legislated rate places a ceiling of 1-1/2 per cent per month on credit cards and retail revolving credit in Montana. That is an easy-to-understand 18 per cent per year. The actual yield to banks and retailers is less than 18 per cent because--unlike cash credit--no finance charges are assessed during the first month of purchase and in the last month when an account is paid off.

(The role of competition in rate setting will be taken up in the following article.)