Joint Legislative Study Commission on the Modernization of North Carolina Banking Laws and the Consumer Finance Act

REPORT TO THE 2010 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY OF NORTH CAROLINA

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STATE OF NORTH CAROLINA

JOINT LEGISLATIVE STUDY COMMISSION ON THE MODERNIZATION OF NORTH CAROLINA BANKING LAWS AND THE CONSUMER FINANCE ACT

April 27, 2010

TO THE MEMBERS OF THE 2010 REGULAR SESSION OF THE 2009 GENERAL ASSEMBLY OF NORTH CAROLINA:

Attached for your consideration is the report to the 2010 Regular Session of the 2009 General Assembly of North Carolina. This report was prepared by the Joint Legislative Study Commission on the Modernization of North Carolina Banking Laws and the Consumer Finance Act.

Respectfully submitted,

Senator David W. Hoyle
Cochair

Representative Hugh Holliman
Cochair

2009 JOINT LEGISLATIVE STUDY COMMISSION ON THE MODERNIZATION OF NORTH CAROLINA BANKING LAWS AND THE CONSUMER FINANCE ACT

MEMBERSHIP

Co-Chairmen:

The Honorable Hugh Holliman, Co-Chair
103 Sapona Road
Lexington, NC 27295
Hugh.Holliman@ncleg.net
919-715-0873

The Honorable David W. Hoyle, Co-Chair
P.O. Box 2567
Gastonia, NC 28053
David.Hoyle@ncleg.net
704-867-0822

House Members:

The Honorable Harold Brubaker
138 Scarboro Street,
Asheboro, NC 27203
Harold.Brubaker@ncleg.net
336-629-5128

The Honorable Susan C. Fisher
7 Maple Ridge Lane
Asheville, NC 28806
Susan.Fisher@ncleg.net
828-258-5355

The Honorable Larry Hall
P. O. Box 25308
Durham, NC 27702
Larry.Hall@ncleg.net
919-682-8823

The Honorable Arthur J. Williams
108 Arbor Dr.
Washington, NC 27889
Arthur.Williams@ncleg.net
252-946-2576

Senate Members:

The Honorable Daniel Blue
4917 Long Point Court
Raleigh, NC
Dan.Blue@ncleg.net
(919) 833-1931

The Honorable Martin L. Nesbitt, Jr.
29 N. Market Street
Asheville, NC 28801
Martin.Nesbitt@ncleg.net
(828) 252-0490

The Honorable Josh Stein
PO Box 10382
Raleigh, NC 27605
Josh.Stein@ncleg.net
(919)715-6400

The Honorable Donald R. Vaughan
612 W. Friendly Avenue
Greensboro, NC 27401
Don.Vaughan@ncleg.net
336-273-1415

Public Members:

Mr. Robert T. Braswell, President & CEO
Carolina Bank
101 North Spring Street
Greensboro, NC 27401
BBraswell@carolinabank.com
336-286-8740

Ms. Beth Young
272 N. Front Street
Suite 342
Wilmington, NC 28401
beth@financialprotectionlawcenter.org
910-442-1010

Mr. Royce E. Everette, Jr.
P.O. Box 6065
Greenville, NC 27835
RE@TimeFinancing.com
252-756-0496
252-714-6879

Ms. Lisa B. McDougald
3200 Beechleaf Ct. Suite 1000
Raleigh, NC 27604
LMcDougald@bbandt.com
919-745-5062
919-745-5065

Ms. Hazel Mack-Hilliard
103 West 3rd Street
Suite 460
Winston-Salem, NC 27101
HazelM@legalaidnc.org
336-725-9162

Mr. Chris McKinley
2630 Ramada Road
Burlington, NC 27215
CMcKinley@greencapfinancial.com
336-329-7190

STAFF

Research Division:
919-733-2578

Karen Cochrane-Brown
Drupti Chauhan
Bill Patterson

Bill Drafting:
919-733-6660

Ryan Blackledge

Commission Clerks:

Carol Bowers ~ 919-715-0873 HollimanLA@ncleg.net
Ted Harrison ~ 919-733-5649 Ted.Harrison@ncleg.net

COMMISSION AUTHORIZATION

S.L. 2009-574

PART XLVIII. JOINT LEGISLATIVE STUDY COMMISSION ON THE MODERNIZATION OF NORTH CAROLINA BANKING LAWS AND THE CONSUMER FINANCE ACT (H.B. 1341 – Holliman, Brubaker)

SECTION 48.1. There is created the Joint Legislative Study Commission on the Modernization of North Carolina Banking Laws and the Consumer Finance Act. The purpose of the Commission is to determine whether and to what extent the North Carolina Banking Laws and the Consumer Finance Act (Article 15 of Chapter 53 of the General Statutes) need to be updated.

SECTION 48.2. The Commission shall consist of 16 members as follows:

(1) Five members of the House of Representatives, appointed by the Speaker of the House of Representatives.

(2) Five members of the Senate, appointed by the President Pro Tempore of the Senate.

(3) One member of the consumer finance industry, one member representing a State-chartered bank, and one member of a consumer advocacy organization, each appointed by the Speaker of the House of Representatives.

(4) One member of the consumer finance industry, one member representing a State-chartered bank, and one member of a consumer advocacy organization, each appointed by the President Pro Tempore of the Senate.

SECTION 48.3. The Commission shall have two cochairs, one designated by the Speaker of the House of Representatives and one designated by the President Pro Tempore of the Senate from among their respective appointees. The Commission shall meet upon the call of the cochairs. Any vacancy on the Commission shall be filled by the original appointing authority. A quorum of the Commission shall be a majority of its members.

SECTION 48.4. The Commission shall study the following issues related to the modernization of the North Carolina Consumer Finance Act:

(1) The increase in costs of operations for the consumer finance industry and its impact on the delivery of products to the public.

(2) The maximum dollar amount that can be lent to an individual consumer.

(3) The appropriate rate of interest and fees to be charged for each level of consumer transaction.

(4) Strategies for increasing consumer protection and disclosure.

SECTION 48.5. The Commission also shall study any issue related to the Banking Laws of North Carolina that the Commission deems appropriate.

SECTION 48.6. Members of the Commission shall receive per diem, subsistence, and travel allowances in accordance with G.S. 120-3.1, 138-5, or 138-6, as appropriate. The Commission, while in the discharge of its official duties, may exercise all powers provided for under G.S. 120-19 and G.S. 120-19.1 through G.S. 120-19.4. The Commission may meet in the Legislative Building or the Legislative Office Building.

With approval of the Legislative Services Commission, the Legislative Services Officer shall assign professional staff to assist the Commission in its work. The House of Representatives' and the Senate's Directors of Legislative Assistants shall assign clerical staff to the Commission, and the expenses relating to the clerical employees shall be borne by the Commission. The Commission may contract for professional, clerical, or consultant services as provided by G.S. 120-32.02. If the Commission hires a consultant, the consultant shall not be a State employee or a person currently under contract with the State to provide services.

All State departments and agencies and local governments and their subdivisions shall furnish the Commission with any information in their possession or available to them.

SECTION 48.7. The Commissioner of Banks shall use up to twenty-five thousand dollars ($25,000) of the funds available to the State Banking Commission for the 2009-2010 fiscal year to fund the study authorized by this act.

SECTION 48.8. The Commission shall report the results of its study and its recommendations, including any proposed legislative changes, to the 2010 Regular Session of the 2009 General Assembly. The Commission shall terminate on May 1, 2010, or upon the filing of its final report, whichever occurs first.

COMMISSION PROCEEDINGS

The Joint Legislative Study Commission on the Modernization of North Carolina Banking Laws and the Consumer Finance Act held 4 meetings between January 27, 2010 and April 27, 2010.

January 27, 2010

Review of Commission's Charge
Ryan Blackledge, Commission Co-Counsel

A Review of the Legislative History of the NC Consumer Finance Act
Karen Cochrane Brown, Commission Co-Counsel

The State of the Consumer Credit Industry in NC
C. Everett Wallace, President, North Carolina Consumer Credit and Personal Finance Council

Comments by Consumer Advocate Organizations
Chris Kukla, Senior Counsel for Legislative Affairs, Center for Responsible Lending
Al Ripley, Director, Consumer Action Network, NC Justice Center

March 24, 2010

A Review of the Supervision of the North Carolina Consumer Credit Finance Industry by the Office of Commissioner of Banks
Mark Pearce, NC Deputy Commissioner of Banks

Review of Survey Conducted by the NC Credit and Personal Finance Council
C. Everett Wallace, President, North Carolina Consumer Credit and Personal Finance Council
Morris Marshburn, RSM McGladrey & Pullen
Bob Esch, RSM McGladrey & Pullen

Response on Behalf of Consumer Advocate Organizations
Chris Kukla, Senior Counsel for Legislative Affairs, Center for Responsible Lending

April 20, 2010

Demographics of Consumer Credit Customers
Jeff Joyner, FirstPoint Resources/Equifax

Remarks from Members of North Carolina Consumer Credit & Personal Finance Council
C. Everett Wallace, President, North Carolina Consumer Credit and Personal Finance Council
Priscilla Butler, President & CEO, Capitol Credit, Greenville, NC
Pam Smith, Chief Financial Officer, Century Finance, Rocky Mount, NC
Chip Williamson, Founder, Creekside Financial, Blowing Rock, NC

April 27, 2010

Remarks on behalf of Credit Counselors
Tom Luzon, Director of Counseling, OnTrack Financial Education & Counseling, Asheville, NC

Response to Industry Report on behalf of Consumers
Louise Mack, Executive Director, Prosperity Unlimited
Chris Kukla, Senior Counsel for Government Affairs, Center for Responsible Lending
Al Ripley, Counsel for Consumer and Housing Affairs, NC Justice Center
Rev. William Barber, President, NC NAACP

Committee Discussion of Draft Report

SUMMARY OF COMMISSION PROCEEDINGS

January 27, 2010

Mr. Ryan Blackledge, Commission Co-Counsel, explained the Commission's charge as set forth in Part 48 of S.L. 2009-574. Ms. Karen Cochrane-Brown, Commission Co-Counsel, provided a review of the North Carolina Consumer Finance Act including its history. The Act allows non-bank lenders to make unsecured loans of $10,000 or less and is governed by the Commissioner of Banks.

Mr. C. Everett Wallace of the North Carolina Consumer Credit and Personal Finance Council presented on the state of the consumer credit industry in North Carolina. He stated that the industry has changed and that the current interest rate structure denies consumers access to the loans they need because the rates have not changed substantially since 1982 nor has the maximum amount of the loans. Mr. Wallace stated that consumer finance companies were closing their offices and not offering some small loans because they were not profitable.

Mr. Chris Kukla, Senior Counsel for Legislative Affairs, Center for Responsible Lending, stated that there is not sufficient data to support an increase in the interest rate or loan limits. According to the Commissioner of Banks' reports, 80% of the consumer loans are made with existing customers or with customers who have had prior loans. His data showed consumer finance companies were opening offices. According to Mr. Kukla, 37 states and the District of Columbia have lower interest rates than North Carolina. The Center for Responsible Lending recommended that there be no increase in rates or loan limits. He stated that there are many other forms of credit for consumers other than consumer finance loans.

Mr. Al Ripley, Director of the Consumer Action Network at the North Carolina Justice Center, provided an overview of recent poverty statistics in North Carolina which indicated increases in poverty and unemployment and a decline in the median income. The Center considers high fees and charges for services and loan products and practices that encourage high cost repeat transactions to be harmful to consumers. The Justice Center recommended that lending laws be changed to reduce fees and rates and discourage high cost financial services. In addition, the State should strengthen programs and services that provide social safety nets and more detailed reporting on consumer finance issues to the Commissioner of Banks.

Senator Dan Blue stated that the scope of the Commission was to address the rates and fees for consumer finance loans; broaden or draw in the loan brackets; and address the maximum amount for loans.

There was Committee discussion around the various issues presented.

March 24, 2010

Mr. Mark Pearce, Deputy Commissioner of Banks, provided an overview and annual report from the Commissioner of Banks regarding the consumer finance industry. He stated that the Commissioner of Banks focuses on broad access to consumer credit, the overall market, industry sustainability, and fairness to the consumer. There are 79 consumer finance lenders in the State. Over the last ten years, the number of consumer credit lenders and number of locations in the State have declined due to a number of different reasons including external factors such as mergers and acquisitions and companies opting to go under federal regulations. The number of smaller loans ($1,000-$3,000) have increased in recent years since the abolishment of payday lending. Loans of less than $1,000 are now declining. Larger loans have increased 149% in the past decade and mid-sized loans are going down. Most of the large loans are made by the two largest consumer finance lenders in the State. Mr. Pearce stated that all of the data is self-reported and all of the lenders do not report in the same fashion. The data shows that about 70% of the consumer finance lenders are profitable in any given year but that the data shows that expenses have increased for consumer finance lenders. Mr. Pearce stated that that the annual report concluded that the market for consumer finance loans has expanded and diversified; the industry has shrunk in the State but not necessarily due to the Consumer Finance Act; and there are big variations in business models for consumer finance lenders. In addition, the report does not provide good insight into the profitability of the consumer finance companies but the industry does not appear to be closing down. Mr. Pearce stated that the Commissioner of Banks does not focus on reasonable returns on equity but whether the consumers are getting the products they need at a fair deal.

Mr. C. Everett Wallace, President of the North Carolina Consumer Credit and Personal Finance Council, stated that there had been increased costs in the consumer finance industry but no change in allowable charges in over 25 years. He then presented a survey made by the Council from December 15, 2009, to January 31, 2010, of customers at various consumer finance offices. Surveyed customers thought the business were trustworthy and helpful; and the companies helped them fulfill their current needs. 99% were very satisfied, felt they were treated fairly, and would refer others. Mr. Wallace was concerned with whether consumer finance companies are profitable and, if not, what should be done to allow for profitability.

Mr. Morris Marshburn and Mr. Bob Esch, both of the accounting firm, RSM McGladrey & Pullen, presented on a report based on a survey conducted of consumer finance companies for the North Carolina Consumer Credit and Personal Finance Council. The report was developed based on information provided by the companies but had not been audited or verified to actual financial reports. The survey responses were from 58% of the total offices in the State and mostly from medium to small lending companies. The data was adjusted to reflect small loan operations so that large lending company figures would not skew the results. The survey showed that the average cost per direct loan in 2008 was $692.37 with an average loss of about $200 per loan. Smaller companies do not have deposits to back the loans and must borrow money to do so. The survey set forth the following: revenue has not kept pace with increasing costs; loan loss provisions have increased; company borrowing costs are volatile; small lenders are owner-operated; and consumer finance loans are a major credit source for many people.

Mr. Chris Kukla, Senior Counsel for Legislative Affairs, Center for Responsible Lending, responded by noting the difficulty of trying to understand the actual financial status of consumer finance companies since different companies report information in different ways. The average loss figure of $200 per loan would translate into $45 to $60 million over the past three years and the companies would have already been out of business. He stated that the survey was a "snapshot" but did not provide all of the data necessary to decide if there was a net gain or net loss.

There was Committee discussion around the various issues presented.

April 20, 2010

Mr. Jeff Joyner, a regional sales manager with FirstPoint Resources, which is an authorized seller for Equifax, presented aggregate information on consumer finance customers in North Carolina. His 2003-2010 data suggests that consumer finance customers are not that different from the rest of North Carolinians. During those seven years, 5.92% of North Carolinians had an open consumer finance account and 60% of those had just one or two accounts. Although North Carolina consumer finance customers tend to have a lower average FICO score than the North Carolina average, the scores are in a somewhat normal distribution. The customers also tend to have other accounts: 62% hold a mortgage, 85% have a credit card on file, 70% have 1-4 auto loans over the past 7 years, and 83% have some sort of banking loan relationship (including auto and home loans).

The committee also heard from members of the North Carolina Consumer Credit and Personal Finance Council, including Pam Smith, Priscilla Butler, Chip Williamson, and C. Everett Wallace.

Ms. Pam Smith, Chief Financial Officer with Century Finance in Rocky Mount, North Carolina, summarized the trouble she sees for her industry: it is a regulated industry with caps on the allowable income, but their costs of doing business are increasing in the market. Ms. Smith wants to continue to lend so as to help borrowers. She expressed frustration in her inability to get out of the business by selling her company because no one wants to buy it. Century Finance also lends for automobile purchases. Those loans represent approximately 60% of loaned dollars and approximately 40% of the number of loans. Century Finance has $17 million in loans, 24 employees, and approximately 6,000 customers.

Ms. Priscilla Butler, President & CEO of Capital Credit in Greenville, North Carolina, reviewed the day-to-day operations of a consumer finance loan office. She explained that the business is a "hands on" operation where employees walk through applications with customers – and also look at the customers' income and expenses to ensure they can repay the loan. Ms. Butler expressed concern over the lack of an allowable late fee, arguing that many customers do not pay on time (80-90%, she estimates) because they do not have a late fee. Ms. Butler pointed out that those customers then experience a hit to their credit score for a late payment. Capital Credit has three offices, $11 million in loans, and 16 employees.

Mr. Chip Williamson, Founder of Creekside Financial in Blowing Rock, North Carolina, stated that the consumer finance industry is a difficult market because one needs knowledge of the regulations and access to capital. Mr. Williamson and his partner started out as a direct personal consumer finance business, but have since diversified into auto loans. Creekside Financial has three offices, $2 million in loans, and approximately 2,000 customers.

Mr. C. Everett Wallace, President of the North Carolina Consumer Credit and Personal Finance Council, stressed the importance of access to short-term capital for low-income customers in a time when many reasonably priced credit products are disappearing. The primary challenge, he explained, is making the industry profitable enough to keep businesses serving the market. He cited two advantages of a consumer finance loan over a credit card: (1) installment loans offer a fixed payment schedule, facilitating putting the payment into a monthly budget and (2) installment loans' 18% is much better than credit cards' 30% rates. The industry is interested in a late penalty – just like credit cards – and would like a small adjustment in the allowable rates to produce a reasonable return on the loans.

The committee discussed various issues, including what is a fair rate, ways to ensure credit continues to flow, the importance of avoiding pushing consumers to non-legal loans, and the overall goal of finding a situation that creates a win-win for all parties.

April 27, 2010

Mr. Tom Luzon, Director of Counseling for OnTrack Financial Education and Counseling said that his organization in Asheville has a staff of ten counselors who advise clients and attempt to help them learn to save money. He noted that adding a late payment would not get these loans paid. He said the reason the payment wasn't being made was because the borrower did not have the funds, so the late payment would only add to the principal balance.

Ms. Louise Mack, Executive Director of Prosperity Unlimited in Kannapolis, said that her organization provides credit counseling to some of the customers of consumer finance companies. She said that sometimes it would be better to tell people "no" on loans because getting the loan makes their financial situation worse rather than better.

Mr. Chris Kukla, Senior Counsel for Legislative Affairs, Center for Responsible Lending reviewed several points that have been presented to the Committee, including (1) 80% of the 2008 loans were made to current or repeat borrowers; (2) 70% of the direct lending companies were profitable; (3) 60% of the loans were made by 2 companies; and (4) 60% of the stores in N.C. are owned by out-of-state companies. He also noted that lending companies often purchase insurance to help recoup losses on loans secured by property. The insurance is paid for by the borrower. Mr. Kukla said that it seems the system is working and there is no necessity to make changes now. He urged that the issue receive more study and that the Commissioner continue to collect data.

Mr. Al Ripley, Counsel for Consumer and Housing Affairs for the North Carolina Justice Center, opposed any change in the law and stressed that in light of the current economy, it is a particularly bad time to raise rates or fees for people who are struggling. Mr. Ripley reminded the committee of the Consumer Union study that showed that 36 states had lending rates that were below the levels in North Carolina, and that nationally the trend is for more consumer protection.

Mr. William Barber, President of the North Carolina NAACP, told the commission that the NAACP was on record as challenging predatory lending practices. He stated that the changes in the law sought by the consumer loan industry would be a step back and he echoed Mr. Ripley's concern that in the current economy, it was not the time to add fees on consumer loans in the State.
The Commission held a discussion on and adopted the draft report.

FINDINGS AND RECOMMENDATIONS

The Joint Legislative Study Commission on the Modernization of North Carolina Banking Laws and the Consumer Finance Act makes the following findings and recommendations to the 2010 Session of the 2009 General Assembly:

FINDINGS:

The Committee finds that:

1. The North Carolina Consumer Credit and Personal Finance Council (Council) believes that the current interest rate structure denies consumers access to the loans they need because the rates and maximum amounts of the loans have not changed substantially since 1982. As a result the Council believes that consumer finance companies can no longer afford to make small loans because of the increases in operating costs faced by the consumer finance companies.

2. Consumer advocacy organizations such as the Center for Responsible Lending believe that there is not sufficient data to support an increase in the interest rate or loan limits. The Consumer Action Network at the North Carolina Justice Center believes that higher fees and charges for services and loan products and practices that encourage high cost repeat transactions are harmful to consumers.

3. The annual report from the Commissioner of Banks shows that about 70% of the consumer finance lenders in the State are profitable in any given year but that the data shows that expenses have increased for consumer finance lenders. The annual report concluded that the market for consumer finance loans has expanded and diversified; the industry has shrunk in the State but not necessarily due to the Consumer Finance Act; and there are large variations in business models for consumer finance lenders. The report does not provide clear information regarding the profitability of the consumer finance companies.

4. There are very divergent views on the state of the consumer finance industry in the State and more consistent and clear data is needed regarding the costs and profitability of the industry as well as its impact on consumers and their access to credit.

RECOMMENDATIONS:

The Committee recommends the following:

1. The Commissioner of Banks should immediately invite an equally proportionate group of borrowers, economic and market experts, consumer advocates and the industry to review these findings. The Commissioner should report to the 2011 General Assembly on the various data and opinions presented in the meetings and provide recommendations for legislation to modernize the Consumer Finance Act.

2. To ensure future policy making has the benefit of necessary, consistent and meaningful financial and operating data about this industry, the Commissioner of Banks should consider both operational information currently gathered by that agency, including the current annual Consumer Finance Industry report, and the reasonable gathering of additional data, or a new format of analysis, that will give legislators and the public clear understanding about its operation and financial results.

3. All recommendations for modifications to the Consumer Finance Act must be linked to the goal of understandable, transparent, effective and fair credit. The laws governing consumer credit must contain all appropriate consumer protections, and must also recognize the requirement for the potential profitability for the lender.