

S B

87

STATE OF ALASKA
THE LEGISLATURE

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May, 1988

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Mary Van Nimwegen

House Judiciary:

5-2-87

HOUSE COMMITTEE REPORT

referred: /3/87

FURTHER REFERRALS: Finance

DATE: 5-2-87

Judiciary Committee has considered CSSB 87 (L&C)

ct relating to the credit card interest rate that may be charged by
in financial institutions."

RECOMMENDATIONS:

replace with _____ the same title
attached amendment(s) a new title

- do pass
- do not pass
- no recommendation
- individual recommendations
- additional referral to the _____ Committee

ISSUES: _____ letter of intent

YES NEW FISCAL NOTE(S):

- fiscal impact same as previous fiscal note published _____
- zero fiscal note same as previous zero fiscal note published 2/11/87
- zero with analysis

YES DO PASS:

[Signature]

[Signature]

SIGNING OTHER RECOMMENDATIONS:

[Signature]

[Signature]

[Signature]
Chairman's signature

Original sponsor: Labor & Commerce
Committee

BY THE LABOR AND
COMMERCE COMMITTEE

1 IN THE SENATE

2

CS FOR SENATE BILL NO. 87 (L&C)

3

IN THE LEGISLATURE OF THE STATE OF ALASKA

4

FIFTEENTH LEGISLATURE - FIRST SESSION

5

A BILL

6 For an Act entitled: "An Act relating to the credit card interest rate
7 that may be charged by certain financial institu-
8 tions."

9 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

10 * Section 1. AS 06.05.209(b) is amended to read:

11 (b) A bank may issue a credit card or other similar credit-
12 granting device to a customer for obtaining money, goods, services or
13 anything else of value and the bank, when credit is extended under
14 this section, may impose a service charge at a monthly rate that
15 results in an annual rate not in excess of 17 percent on the out-
16 standing balance [THE LIMITS FOR SERVICE CHARGES PROVIDED IN AS 45.-
17 10.120(c)]. However, in addition, when cash is advanced under this
18 section, the bank may impose a setup charge that [WHICH] does not
19 exceed three percent of the funds advanced, or \$12, whichever is less,
20 except that on loans of under \$100 a minimum not exceeding \$3 may be
21 charged.

100 = \$3.00 charge

*Ann Exp - Optima Card fee 15
Ann Exp Green CI 4.40
annual fee → 55*

TESTIMONY BEFORE SENATE LABOR & COMMERCE COMMITTEE

Mr. Chairman, my name is Wes Coyner and I am representing the Alaska Bankers Association who support passage of CSSB87.

What this bill will do is provide a single legal maximum interest rate on the outstanding balances on credit cards.

Under current Alaska law we have a two tier interest rate structure which is outdated and works to the disadvantage of the less affluent consumer.

It provides for maximum rate of 18% on the first \$1,000 owed on local bank cards and a lower rate on balances over \$1,000 that floats at five points above the federal discount rate. The rate on balances over \$1,000 is now 10.5%. That is the problem - rates are too high on balances under \$1,000 and too low on balances over \$1,000.

As a result of our current two tier system approximately 150,000 Alaskans who have VISA and MASTERCARD cards issued by Alaska banks, are not getting the full benefits of falling interest rates in todays market.

In addition, current statute places Alaska banks, who offer credit cards, at a competitive disadvantage with out of state banks who have captured approximately half of the Alaska credit card market. Ironically, most of those banks charge a higher interest rate than local banks and higher than that proposed in this bill.

Further, existing law discourages Alaska banks from issuing new cards, which in turn effects the number of people employed in their card operations and forces many Alaskans to use out of state cards at higher rates than Alaska law allows. State laws do not apply to out-of-state banks who issue cards under more liberal laws of their home states. Thirteen states have no limit and all but five states allow rates that vary from 18% to 30%.

The credit card market in Alaska is becoming increasingly competitive, but because other card issuers are operating under another states more favorable law, or federal regulation, Alaska's banks are seriously disadvantaged.

For example, Alaska National Bank of the North recently sold their credit card operation to Seattle First National Bank, which unfortunatley eliminated about 14 jobs in Alaska. Now, because Seafirst operates under Washington State law, they will be offering their card in Alaska at a 15% rate.

Another example, two Credit Unions in Alaska governed by Federal Regulations that allow an interest rate of up to 21%, are offering their cards at 13.9% and 16%.

Existing law and federal regulations allows our competitors in state and from out of state to do things that we cannot do, and our law in its present form is not beneficial to lower income consumers.

We have a situation in which most of Alaska-issued card owners (approximately 2/3), who carry relatively low balances, wind up paying the maximum 18%, while a minority of the more affluent, who qualify for the premium bank cards with larger credit lines, can carry large balances and pay 10.5% on some of it. Consequently, to make up for lower earnings on this money, banks must push the rate to the maximum 18% on the lower balances. This has the effect of the more affluent using the cards as a source of cheap consumer credit and being subsidized by the average consumer who carries a smaller credit balance.

Our current structure has created inequities for both businesses in Alaska, who want to provide jobs, and for the small or average consumer who desires a lesser interest rate.

Passage of CSSB87 would correct those inequities.

Banks would be able to compete on even terms with out of state banks by providing more cards to Alaskans seeking them, thereby expanding their card base, which in turn can lead to expanded operations and employment which we all know is desperately needed in Alaska now.

Most consumers would benefit by having one rate to consider rather than the confusing two tier system that now penalizes the lower balance user.

For those who are concerned about a maximum rate of 17% as set forth in CSSB87, remember that the maximum rate cannot be charged in todays competitive market if you want to survive and expand your card base, which Alaska card issuers want desparetly to do.

A good example is the Credit Unions mentioned earlier - even though they can charge rates of up to 21% under Federal Regulations their current rates are 5-7% less than the maximum allowable.

In this regard, one of the two remaining Alaska banks offering credit cards will commit, in todays market, to a single or blended rate of 16.5% or less, with passage of CSSB87. Thus, immediately reducing the 18% rate currently being paid by approximately two thirds of that banks card holders.

The other bank also intends to be very competitive and both banks are desirous of expanding their market base, which by design, has been relatively stagnant for several years because of our restrictive rate limits.

To expand their base and attract new customers, they must offer rates comparable to those available from other institutions both in state and out.

Alaska banks welcome that competition and encourage the customer to shop for their card - however - they want to be able to compete by the same rule as outside card issuers. CSSB87 will accomplish that to a degree.

Through this bill we are asking you to allow Alaska banks, who are employing Alaskans and want to expand their card operations, and quite likely increase employment, the same opportunity afforded non-Alaskan businesses and those governed by Federal Regulation.

Also keep in mind, the 17% maximum rate called for in this bill is less than the maximum rate in 44 of the other states.

Our current, out of step law, no longer protects or benefits the average consumer who it was designed to protect, and has put Alaska banks into a disadvantaged position against out of state card issuers.

CSSB87 will correct these problems and benefit both the consumer and Alaska banks to compete on more equal terms.

ALASKA WOMEN'S LOBBY

POST OFFICE BOX 10-1571, ANCHORAGE, ALASKA 99510

Testimony on SB 87

The two-tier system which this legislation seeks to change was created in order to protect consumers during periods of high interest rates.

The banking industry now feels it must have a single rate system because it is too limited in the amount of interest it may charge to those with higher balances and therefore has no choice but to charge the maximum interest to the average consumer.

Interestingly, even during the periods of high interest rates the average consumer was still charged the maximum interest allowed by statute. Indeed, the Division of Banking testified at the House Labor and Commerce Committee that at no time since the 1960's have consumers had relief from the maximum interest rate.

We do not wish to stand in the way of the change to a single rate system if the change will result in a substantial and guaranteed savings to the majority of card-holders.

But what we are guaranteed in SB 87 is that those consumers who carry large balances will see an immediate increase of $6\frac{1}{2}$ percent while those with smaller balances will see their rates decreased only 1 percent.

Since the major amounts of cash lent by the banks are to those with the larger balances - it is the banks and not the consumers who stand to benefit the most by passage of this bill.

We would like to note that despite a sluggish economy Alaskan banks have experienced continued growth. According to recent reports in the Juneau Empire the First National Bank of Anchorage's total assets are up \$106 million compared to the first quarter of 1986. Deposits are also up by \$76 million and the National Bancorp of Alaska announced a 2.4 percent increase in deposits.

There is legislation moving through Congress now, which if passed, would impose a national ceiling on credit card interest rates. The rate they are proposing would float at eight percentage points above the yield on one-year Treasury securities. It would be 13.8 percent today.

We feel that if we must move away from a system created to protect consumers then we should provide a substantial savings to the majority of consumers and we would urge you to consider lowering the ceiling to 16 percent or less.

We would ask you to consider that the federal discount rate or the cost of money is currently between 5-6 percent and that surely the 10 percent difference between that rate and 15 or 16 percent is wide enough to allow a sufficient profit to the banks while allowing a real savings to the average consumer.

Thank you for your consideration.

1.14 FEDERAL RESERVE BANK INTEREST RATES

Percent per annum

Current and previous levels

Federal Reserve Bank	Short-term adjustment credit and seasonal credit ¹			Extended credit ²						Effective date for current rates
				First 60 days of borrowing		Next 90 days of borrowing		After 150 days		
	Rate on 9/26/86	Effective date	Previous rate	Rate on 9/26/86	Previous rate	Rate on 9/26/86	Previous rate	Rate on 9/26/86	Previous rate	
Boston	5½	8/21/86	6	5½	6	6½	7	7½	8	8/21/86
New York		8/21/86								8/21/86
Philadelphia		8/22/86								8/22/86
Cleveland		8/21/86								8/21/86
Richmond		8/21/86								8/21/86
Atlanta		8/21/86								8/21/86
Chicago		8/21/86								8/21/86
St. Louis		8/22/86								8/22/86
Minneapolis		8/21/86								8/21/86
Kansas City		8/21/86								8/21/86
Dallas		8/21/86								8/21/86
San Francisco	5½	8/21/86	6	5½	6	6½	7	7½	8	8/21/86

Range of rates in recent years³

Effective date	Range (or level)—All F.R. Banks	F.R. Bank of N.Y.	Effective date	Range (or level)—All F.R. Banks	F.R. Bank of N.Y.	Effective date	Range (or level)—All F.R. Banks	F.R. Bank of N.Y.
In effect Dec. 31, 1973	7½	7½	1978— Aug. 21	7¾	7¾	1982— July 20	11½-12	11½
1974— Apr. 25	7½-8	8	Sept. 22	8	8	23	11½	11
30	8	8	Oct. 16	8-8½	8½	Aug. 2	11-11½	11
Dec. 9	7½-8	7¾	20	8½	9½	3	11	10½
16	7¼	7¾	Nov. 1	8½-9½	9½	16	10½	10
			3	9½	9½	27	10-10½	10
1975— Jan. 6	7¼-7¾	7¾				30	10	10
10	7¼-7¾	7¾	1979— July 20	10	10	Oct. 12	9½-10	9½
24	7¼	7¾	Aug. 17	10-10½	10½	13	9½	9½
Feb. 5	6¾-7¼	6¾	20	10½	10½	Nov. 22	9-9½	9
7	6¾	6¾	Sept. 19	10½-11	11	26	9	9
Mar. 10	6¾-6¾	6¾	21	11	11	Dec. 14	8½-9	9
14	6¾	6¾	Oct. 8	11-12	12	15	8½-9	8½
May 16	6-6¾	6	10	12	12	17	8½	8½
23	6	6						
1976— Jan. 19	5½-6	5½	1980— Feb. 15	12-13	13	1984— Apr. 9	8½-9	9
23	5½	5½	19	13	13	13	9	9
Nov. 22	5½-5½	5½	May 29	12-13	13	Nov. 21	8½-9	8½
26	5¼	5¼	30	12	12	26	8½	8½
			June 13	11-12	11	Dec. 24	8	8
1977— Aug. 30	5¼-5¾	5¼	16	11	11			
31	5¼-5¾	5¼	July 28	10-11	10	1985— May 20	7½-8	7½
Sept. 2	5¾	5¾	29	10	10	24	7½	7½
Oct. 26	6	6	Sept. 26	11	11			
			Nov. 17	12	12	1986— Mar. 7	7-7½	7
1978— Jan. 9	6-6½	6½	Dec. 5	12-13	13	10	7	7
20	6½	6½	8	13	13	Apr. 21	6½-7	6½
May 11	6½-7	7				23	6½	6½
12	7	7	1981— May 5	13-14	14	July 11	6	6
July 3	7-7¼	7¼	8	14	14	Aug. 21	5½-6	5½
July 10	7¼	7¼	Nov. 2	13-14	13	22	5½	5½
			6	13	13			
			Dec. 4	12	12	In effect Sept. 26, 1986	5½	5½

1. After May 19, 1986, the highest rate within the structure of discount rates may be charged on adjustment credit loans of unusual size that result from a major operating problem at the borrower's facility.

2. A temporary simplified seasonal program was established on Mar. 8, 1985, and the interest rate was a fixed rate ½ percent above the rate on adjustment credit. The program was re-established on Feb. 18, 1986; the rate may be either the same as that for adjustment credit or a fixed rate ½ percent higher.

3. Applicable to advances when exceptional circumstances or practices involve only a particular depository institution and to advances when an institution is under sustained liquidity pressures. As an alternative, for loans outstanding for more than 150 days, a Federal Reserve Bank may charge a flexible rate that takes into account rates on market sources of funds, but in no case will the rate charged be less than the basic rate plus one percentage point. Where credit provided to a particular depository institution is anticipated to be outstanding for an unusually prolonged period and in relatively large amounts, the time period in which each

rate under this structure is applied may be shortened. See section 201.3(b)(2) of Regulation A.

4. Rates for short-term adjustment credit. For description and earlier data see the following publications of the Board of Governors: *Banking and Monetary Statistics, 1914-1941*, and *1941-1970: Annual Statistical Digest, 1970-1979, 1980, 1981, and 1982*.

In 1980 and 1981, the Federal Reserve applied a surcharge to short-term adjustment credit borrowings by institutions with deposits of \$500 million or more that had borrowed in successive weeks or in more than 4 weeks in a calendar quarter. A 3 percent surcharge was in effect from Mar. 17, 1980, through May 7, 1980. There was no surcharge until Nov. 17, 1980, when a 2 percent surcharge was adopted; the surcharge was subsequently raised to 3 percent on Dec. 5, 1980, and to 4 percent on May 5, 1981. The surcharge was reduced to 3 percent effective Sept. 22, 1981, and to 2 percent effective Oct. 12. As of Oct. 1, the formula for applying the surcharge was changed from a calendar quarter to a moving 13-week period. The surcharge was eliminated on Nov. 17, 1981.

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Credit cards competitive?

THE ASSOCIATED PRESS

WASHINGTON - The chairman of a Senate Banking subcommittee is warning banks that issue Visa and MasterCard credit cards to begin competing on interest rates or risk new legal curbs on the rates they can charge.

Sen. Christopher Dodd, D-Conn., opening a hearing by his consumer affairs subcommittee, said Tuesday he disliked the idea of a national cap on interest rates, calling such a ceiling "a simple - and wrong - solution to a complicated problem."

Georgia Lawmakers Vote to Kill Rate Ceiling on Credit Cards

Special to the American Banker

ATLANTA — Georgia's General Assembly has voted to give credit card issuers within the state complete freedom to set their own interest rates and fees.

The bill, approved Thursday, abolishes the state's 18% ceiling on annual interest rate charges and the \$12 limit on annual fees. It also permits the establishment of special credit card banks in Georgia, a feature that proponents say will create hundreds of new jobs.

The House passed the measure 138 to 34 and immediately sent it to the Senate, where it was approved by a 42-to-1 vote. The bill requires the governor's signature to become law.

Rep. James M. Beck, D-Valdosta, sponsor of the bill in the House, said deregulation of rates and fees would allow banks to offer a wider variety of credit cards here. He also predicted that as many as a dozen financial institutions would open credit card banks here within a year.

"I can't overemphasize the employment aspect of the bill," he said. "That's what it's all about. But we can't have one part [new banks] without the other [credit card deregulation]."

Under the bill, a credit card bank would have to employ at least 50 people or contract with a Georgia credit card processing company that employs

at least 250 people.

Rep. Jack Connell, D-Augusta, sought an amendment in the House that would have lowered the required number of employees at a Georgia processor. He said he wanted to open the card processing business to more small companies. The amendment lost on a voice vote.

Other representatives claimed banks would respond to the bill by raising their interest rates and fees.

"The \$12 fee will be \$45 in no time flat," said Rep. William S. Jackson, D-Martinez.

Rep. Rudolph Johnson, D-Lake City, who offered an amendment that would have lowered the ceiling on interest rates from 18% to 14%, said bankers have not let credit card rates follow other market rates downward.

Mr. Beck and other proponents warned, however, that if the bill failed, Georgia banks might choose to move their credit card operations to a deregulated state.

The deregulation of credit cards applies only to cards issued by financial institutions, including banks, savings institutions, and credit unions.

It does not affect cards issued by department stores and other retailers, who are limited in Georgia to a 21% annual interest rate. They are not permitted to charge an annual fee. ■

Alaska laws keep card rates high



tim bradner

You might not have noticed, but the interest you pay on your VISA or MasterCard depends very much on whether it was issued by an "Outside" bank like Citibank or Bank of America, or an Alaska bank. It can make a real difference, because the interest charged by local banks can be considerably less. But not as cheap as it could be. Therein lies an interesting story.

This is hard to believe, but sadly true: Alaska's law restricting interest rates on credit cards puts local banks at a competitive disadvantage with out-of-state financial institutions, results in local consumers paying higher rates, raises the possibility of local jobs being eroded and, surprisingly, results in a minority of relatively affluent Alaskans being, in effect, subsidized by the rest of us.

You'd think legislators would rush to change this. In fact, they tried to. A bill did pass both the House and Senate, but it died in the confusion during final hours of the legislative session.

The law governing these interest rates is relatively obscure, a relic of the days of high interest rates, high inflation and the notion that economic problems can be solved by price controls and government regulation. But because of it, out-of-state financial institutions have been able to market their own credit cards aggressively here, capturing about half the Alaska charge card market. Because Alaska's limitations on interest don't apply to them, they can charge higher rates as well.

Alaska is one of five states that still have laws restricting interest rates on

locally issued credit cards that are lower than they would be on the open market. However, the problem is not so much the limit but the way the limit is structured.

We have a "two-tier" limit in Alaska, a top rate of 18 percent on the first \$1,000 owed, and a lower interest rate, applying to balances over \$1,000, that "floats" at five points over the federal discount rate. The discount rate has been falling, so this lower rate is now about 11.5 percent.

Like any price control, these limits create shortages and market distortions. The shortage is in the ability of the local banks to offer their lower-cost credit card services to large numbers of Alaskans, many of whom then turn to cards issued by out-of-state financial institutions to which the Alaska limits do not apply. Rates charged on these cards approach 20 percent. For example, Citibank and Bank of America charge 19.8 percent for their VISA and MasterCard accounts, as does Sears with its new Discover card.

But the most bizarre distortion is this:

The "two-tier" structure of Alaska's law creates a situation in which most of Alaska-issued card owners who carry relatively low balances wind up paying the maximum 18 percent, while a minority of the more affluent, who qualify for the premium bank cards with larger credit lines, can carry large balances and pay 11.5 percent on some of it. In effect, they are using the cards as a source of cheap consumer credit and are being subsidized by the rest of us who pay 18 percent.

This is the crux of the matter. Alaska bank earnings are marginal when servicing charge card accounts at 11.5 percent. To make up for lower earnings on this money, they must push the rate to the legal 18 percent maximum on the other money lent. Even with that, bank card services are no big money-maker for local banks.

Credit card operations are more complex and costly than conventional bank lending because of added costs in processing, handling and mailing. What this means is that to stay in the business, local banks must keep costs to a minimum, particularly the inevitable bad debt losses. They can do this by being very restrictive to whom they issue cards.

This has made Alaska a happy hunting ground for out-of-state financial institutions that are regulated under more liberal laws of their home states. With modern communications and data-processing technology, they locate card

See Page J-5, CREDIT

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CREDIT: Laws keep rates high

Continued from Page J-1

operations in states with liberal laws and can aggressively promote their cards nationwide because they charge higher rates and have a huge volume to make up losses. Local banks, in contrast, have less volume, less margin and higher costs, partly because they maintain their operations and people here.

The legislation that died in Juneau would have wiped out this lower "tier" of interest limitation to leave just one limit on the total of the amount owed. In fact, in final versions of the bill, the top "cap" would have been reduced from 18 to 17 percent.

But the actual rate would be determined by competitive market forces here and would "float" down to around 16.5 percent, Alaska bank officials say. Because there no longer would be a need to subsidize the lower limit, rates for most people would go down. But the overall return to the banks would increase. A greater margin would permit more liberal card-issuing, more volume, an ability to capture back more market share from the Outsiders, and lower interest rates on charge cards for most Alaskans.

Cynics doubt rates would actually fall. Local bankers point to other states with relatively high legal limits, or even no limits, where actual rates, established by market competition, are lower. They point to Washington, where the legal ceiling is 18 percent but Seafirst and Rainier banks charge 15 percent on their cards.

Critics respond: the Alaska banking community is small and dominated by a few big banks. There might not be enough competition for market forces to bring down rates.

Most legislators finally grasped the subtle complexities of this issue, though not in time to see a change in the law this year. It's tempting in politics to rely on the notion that government can "fix" a problem with a regulation or a control. It's more difficult to see the long-range effects or to really trust that free-market forces and deregulation in the financial community can really benefit consumers.

If legislators do allow interest rate deregulation, it will be interesting indeed to see how free-market forces will actually perform.

□ Tim Bradner writes for an Alaska economic reporting service.
