AFSA
Protecting Credit Since 1916
American Financial Services Association

The Need to Preserve Quality Credit Options in Regulation

For at least the last 100 years, there has been a need for small dollar credit. That need continues today in the early years of the 21st century. The Consumer Financial Protection Bureau (CFPB) is in the process of developing proposals to oversee small-dollar credit, including payday, title, and traditional installment loan products. It is paramount that the bureau does its due diligence to draw a sharp line of distinction between nefarious, predatory products and quality, responsible, and data-driven loans offered by traditional installment lenders.

NEED

Traditional installment loans often meet an urgent need for many consumers. Repairing the family car, purchasing costly medical supplies or simply making ends meet at the end of the month are reasons for Americans to use traditional installment loans.

A recent TransUnion study noted that as of the third quarter of 2015, 13.72 million consumers held a traditional installment loan. Borrowers from all over the credit spectrum hold traditional installment loans as well, with nearly 6.46 million consumers in the "prime or better" risk tiers with loans.

QUALITY

A high-quality small dollar loan *IS*:

- Made with a high confidence in the borrower's ability to repay
- Priced to align profitability for the provider with success for the borrower
- Creates opportunities for upward mobility and greater financial health
- Has transparent marketing, communications, and disclosures
- Accessible and convenient
- Provides support and rights for borrowers
- Reports payment activities to credit bureaus

A high-quality small-dollar loan *IS NOT*:

- Reliant on a consumer's collateral as opposed to their credit worthiness
- Made with knowledge that the borrower is unlikely to repay the loan
- Made with loan renewal as a primary source of business to the lender
- Made with balloon or large one-time payments

Traditional installment loans have low delinquency rates relative to other small-dollar loan products. In the fourth quarter of 2015, the delinquency rate (those 60 days+ past due) was just 3.54%. Moreover, TransUnion projects the number of traditional installment loans to increase over the next several years, but expects delinquency rates to remain flat.

GETTING IT RIGHT

Traditional installment loans have been regulated at the state level for decades. The CFPB has not provided any evidence that this level of regulation has been inadequete. For the first time, these responsible, well-made credit products will be regulated at the federal level by the CFPB. The bureau must exercise extreme caution when writing proposals that govern small-dollar loans.

One of the CFPB's stated objectives is to protect consumers from the harmful characteristics of payday, title and similar short-term loan products. AFSA agrees – consumers must be aware of and have protections against financial instruments that will trap them in a cycle of debt. However, the bureau's proposal at this point is written so broadly as to include traditional installment loans.

Unlike the loans that the CFPB intends to regulate with this proposal, traditional installment loans do not have prepayment penalties or large, one-time balloon payments. They are fully-amortizing loans. Traditional installment loans are paid off through equal monthly payments of principal and interest that provide a clear path to repayment. Moreover, traditional installment lenders report payment activity to credit bureaus, meaning that consumers can build or repair damaged credit.

Annual Percentage Rate (APR) is a tool used to compare similar loan products side-by-side. When comparing loans, like a home mortgage paid back over several decades, it is useful. However, on a small-dollar loan, like a traditional installment loan, paid back over a much shorter period of time, and for a far smaller amount of money than a mortgage, it simply cannot be used. It is also important to note that payday loans carry interest rates markedly higher than traditional installment loans, sometimes in excess of 400%, and are not underwritten or amortized and payment history is not reported to credit bureaus.[2]

If the bureau does not limit the rulemaking to payday and title loans, lenders may choose not to make loans above the proposed 36% all-in APR for two main reasons:

1 Traditional installment lenders cannot afford the reputational risk of being associated with payday lenders. To avoid being seen as anything resembling payday or title, they may choose not to offer a product that is labeled by the CFPB as a "covered" loan under a payday or title loan rule. This may mean that consumer will have to borrow more money to stay under the 36% all-in APR set by the CFPB, provided they qualify. More likely, consumers will be forced to unscrupulous loan sharks to get the money they need.

2 Traditional installment lenders simply cannot make small-dollar loans, especially with the proposed income verifications standards, at a 36% all-in APR. According to a study done by three academics using industry data, in order to make break-even loan at a 36% APR, the loan would have to be made for at least $2,600. For a loan to be made profitability at a 36% all-in APR, the loan would have to be for around $4,000. In a bureau field hearing on military lending, almost all the panelists told the bureau staff that it was impossible to make such loans. A Federal Deposit Insurance Corporation (FDIC) pilot study on small-dollar loans showed that banks could only make these loans as loss-leaders.

[2] *Teschen, J., & Brockland, B. (2014, February 27). A Playbook for Small-Dollar Credit. http://www.americanbanker.com/a-playbook-for-small-dollar-credit-1065908-1.html*