



February 13, 2014

The Honorable Michael S. Sanchez
New Mexico Senate
State Capitol, Room 119
490 Old Santa Fe Trail
Santa Fe, NM 87501

The Honorable Gail Chasey
New Mexico House of Representatives
State Capitol, Room 308A
490 Old Santa Fe Trail
Santa Fe, NM 87501

Re: SJR 20 / HJR 10 Proposing to Reduce the Maximum Lawful Annual Interest Rate for the Extension of Credit

Dear Senator Sanchez and Representative Chasey:

On behalf of the American Financial Services Association (AFSA),¹ I would like to register deep concerns with Senate Joint Resolution 20 / House Joint Resolution 10, which would amend the New Mexico Constitution to limit the maximum lawful rate of annual interest for the extension of credit at 36 percent. We strongly oppose this amendment on the grounds that Annual Percentage Rate (APR) is an inefficient and misleading measure of the cost of certain types of loans, and that imposing a cap on APRs will eradicate safe forms of credit as well as riskier forms, leaving only unregulated Internet or black market options to meet demand.

Rate caps of this kind have been considered in other states as a regulatory solution to problems associated with payday and title loans, which are seen by many as a risky form of credit. This has been in spite of the fact that rate caps also affect safer credit, such as the traditional installment loans made by AFSA members.

Installment loans are relatively small loans to individuals, fully underwritten and paid back over time in equal installments comprising both principal and interest. They differ from payday and title loans in many ways, but most significantly in that they do not carry a “balloon payment” – the full amount of the loan plus fees and interest, due at a certain time. Balloon payments leave borrowers who cannot repay their loan at the time it is due with no alternative but to refinance the loan and thus become trapped in a “cycle-of-debt.”

Imposing a ceiling for Annual Percentage Rates (APR) does not have the effect that many in the media and the general public think it does. APR is not the same as an “interest rate,” which is a predetermined and agreed element of the cost of a loan. In the case of short-term, small-dollar loans,

¹The American Financial Services Association is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA member financial institutions offer vehicle financing, cards, personal installment loans and mortgage loans. The Association encourages and maintains ethical business practices and supports financial education for consumers of all ages.

APR is an artificial annualization of the interest element of the cost of a loan, the term of which may only be a few weeks. In fact, APR is a mathematical tool that has value only as a comparator between identical products. It is particularly poor when it comes to benchmarking the *actual* cost of a traditional installment loan.

The Truth in Lending Act (TILA) requires that creditors disclose not only APR, but also the Amount Financed (the size or quantity of the credit product), Finance Charge (the absolute dollar cost of the credit product) and the Total of Payments (the cash flow that will be required to service the credit product over its life). The only way for a consumer to make a valid comparison between loan options and thereby make an informed choice as to a loan's affordability is to examine all four of these elements and determine which product is best for them. Using only APR would lead the borrower astray, providing a false impression of the cost of a loan. Using APR as a regulatory tool would do the same; making a judgment about the loan's cost without all of the information needed to do so. Imposing an arbitrary limit on APRs will mean that people who need small loans will be forced to borrow more money for longer terms, pay higher real charges, or be denied access to credit altogether as lenders are forced to discontinue lending operations in New Mexico. This is what happened in Japan, where artificially imposed APR caps have, in effect, wiped out much of that country's formal consumer lending industry. Borrowers are forced to look elsewhere for credit – to loan sharks and other illegal options. This must be guarded against very carefully here in New Mexico.

For this reason, we urge that you rethink your plan to impose rate caps in New Mexico and seek out other legislative solutions to any challenges you have identified. If you feel you cannot do that, we ask that you preserve access to small dollar credit for New Mexico's neediest borrowers by exempting safe, traditional installment loans from any rate cap laws. This kind of exemption has a precedent – at the Federal level, the John Warner National Defense Act of 2007 imposed rate caps on payday and title lenders that lend to military personnel, yet specifically exempted traditional installment loans, recognizing the need to protect what it called “beneficial or benign” installment credit while identifying and attacking payday loan products.

Exempting installment loans from any new laws would ensure that a safe source of credit is preserved for New Mexico borrowers and a “credit desert” situation is avoided. This can be done with the reassurance that the nature and structure of installment loans clearly differentiates them from payday and other more risky forms of small-dollar credit. Installment loans offer better terms and higher levels of safety. Furthermore, they are a form of credit that has been in existence for more than a century and are highly regulated at both the state and federal levels. Installment lenders underwrite their loans dependent on borrowers' stability, ability and willingness to pay. Specifically:

- Installment lenders, unlike other providers of small loans, assess a borrower's willingness to repay a loan through credit checks. They also report back to the credit bureaus allowing their customers to enhance their credit scores.
- Installment lenders do not take post-dated checks or directly access borrowers' bank accounts as a condition of the loan.
- Installment lenders schedule repayments in equal installments made up of principal and interest, giving the borrower a clear and attainable path out of debt.

I hope you take away from this letter a clear picture of the risk to credit access for needy borrowers in New Mexico posed by this proposed rate cap and the radical differences between payday and title loans and safer traditional installment loans.

We respectfully request that you reconsider SJR 20 and HJR 10 in the light of this information and give this letter due consideration. If you have further questions, please do not hesitate to contact me by phone 952-922-6500 or email dfagre@afsamail.org.

Respectfully,



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CC:

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